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# SUPPLEMENT TO INCOME TAX PROCEDURE 1919

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# SUPPLEMENT TO INCOME TAX PROCEDURE 1919

## CHAPTER II

### APPLICATION OF THE LAW—EXEMPTIONS

#### Page 47

“HEAD OF A FAMILY” DEFINED.—Article 302, Reg. No. 45, 1919, provides: “A head of a family is a person who actually supports and maintains in one household one or more individuals,” etc. As stated on page 48, the newspapers have reported that the restriction imposed by the words “in one household” was eliminated, but no official ruling setting aside Article 302 of the Regulations has appeared.

#### Page 49

EXEMPTIONS TO BE CALCULATED BY MONTHS.—On March 11, 1919, the following announcement was made by the Bureau of Internal Revenue, holding that the status of an income taxpayer on the last day of his taxable year (which in most cases was December 31, 1918) will determine his personal exemption for the entire preceding year:

The subdividing of personal or family exemptions to cover a person's changes in status during 1918 is abandoned. Paragraph three of Section six of the instructions on forms 1040 and 1040 A are made void by the new ruling.

When claiming the personal or family exemption on his return, a taxpayer should be guided by the following schedule of lawful allowances.

If married and living with wife (or husband) on the last day of the year, the exemption allowed is \$2,000. Any taxpayer who, though unmarried, supported in his household on December 31 one or

<sup>1</sup>The chapter references correspond with the similar chapters in 1919 *Income Tax Procedure*.

more relatives who were dependent upon him, may claim the \$2,000 exemption.

Single persons, also married persons who were living apart on December 31, and who have no dependents, may claim only \$1,000 exemption.

Additional exemption of \$200 is allowed for each person who was dependent upon the taxpayer on December 31 if the dependent is under 18 years of age or is mentally or physically incapable of self-support.

Taxpayers who have already filed returns on the former basis must now file amended returns. Amended returns, however, may be made within a reasonable time at the convenience of the taxpayer.

A young man who earned \$1,300 during the year 1918 and who reached his twenty-first birthday any time prior to December 31, 1918, will have to file a return. As stated on page 81, he should have been required to file a return in any event even though a minor, but the author has been asked certain questions which indicate that many young men think they are not liable to the income tax until they have reached their twenty-first birthday.

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HUSBAND AND WIFE LIVING APART.—Article 303, Reg. No. 45, states that "a resident alien with a wife residing abroad is not entitled to the \$2,000 exemption."

Page 51

#### PERSONAL EXEMPTIONS OF NON-RESIDENT ALIENS.—

REGULATION. A non-resident alien individual, similarly to a citizen or resident, is entitled for the purpose of the normal tax to credit corporate dividends, interest on obligations of the United States, a personal exemption, and \$200 for each dependent, except that in the last two cases if he is a citizen or subject of a country which imposes an income tax the credit is allowed only if his country allows a similar credit to citizens of the United States not residing in such country. By "similar credit" is meant the same personal exemption or credit for dependents to citizens of the United States as is allowed citizens of such country, not necessarily the same amount as in the United States statute. (Reg. No. 45, Article 305.)

This means substantially that in foreign countries there must be no discrimination against Americans as compared with the citizens of the country imposing the tax. (T. D. 2811.) (March 22, 1919) gives an incomplete list of countries. (See Chapter XXVIII for full text of decision.)

Pages 54, 61 and 201

### **Income Exempt from Both Normal and Surtaxes**

**War risk insurance.**—Since June 25, 1918, no assessment of any federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1914, as amended, even though the benefit accrued before that date. Any return filed as the basis of an assessment to be made after June 25, 1918, should not include such benefits as part of taxable income.

**Compensation of state employees held to be exempt.**—Article 71, Reg. No. 45, provides:

REGULATION. . . . . Compensation paid its officers and employees by a state or political subdivision thereof, fees received by notaries public commissioned by states, and the income of State workmen's compensation insurance funds established by State statutes, are not taxable. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a state, are not required to return as taxable incomes the salaries so received. (Reg. No. 45, Article 71.)

The basis of holding that the compensation of state employees is exempt is indicated by the first few lines of Article 71, Reg. No. 45, which state in effect that the exemption arises out of the fact that such income is "by statute or fundamental law free from tax." In view of the repeated statements in Congress holding that state employees were subject to the federal income tax, and the failure to re-enact the specific exemption which had been accorded to such employees in the former laws, the action by the Commissioner, who states

in effect that such employees are exempt, either by statute or fundamental law, forecloses the judicial determination which Congress intended.

It is to be regretted that the question was not left to the courts as was intended, because the freedom from the federal income tax of well-paid state and municipal employees creates an unfavorable impression on those who are for the first time subject to the federal income tax. Another reason why the right to tax state employees should be tested is the fundamental justice of it in a time of emergency. The Bureau of Internal Revenue issued the following statement March 3, 1919:

Many inquiries are being received by the bureau from all parts of the United States, indicating that there is a doubt as to whether officers and employees of States or political subdivisions must consider their compensation as taxable income. The view of the bureau that such income is exempt is determined by the reading of the law, by the apparent intention of Congress, and by the fundamental law governing the relation between the Federal Government and the States.

The conference committee which considered the views of the Senate and the House of Representatives with respect to the new revenue act, and revised the bill as passed by both Houses, wrote into Section 213 special clauses which include in taxable income the compensation of the President, the Federal Court judges, and all other officials and employees of the United States, or of any State, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia. Before reporting the bill back to the Senate and the House, the words "or of any State" were stricken out, and with this revision of the conference committee's special clauses in Article 213, the act was accepted and passed by Congress.

This statement is in conflict with the report of the Finance Committee of the Senate. (See page 201.) The statement refers to the "apparent intention of Congress," but as a matter of fact after many hours of discussion Congress refused to include the former exemptions extended to state employees.

Page 54

**Dividends and interest from federal land bank and national farm loan association.—**

REGULATION. As Section 26 of the Federal Farm Loan Act of

July 17, 1916, provides that every federal land bank and every national farm loan association, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate, and that farm loan bonds, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of federal land banks and national farm loan associations and from interest on such farm loan bonds is not subject to the income tax. (Reg. No. 45, Article 74.)

#### **Dividends from federal reserve bank.—**

REGULATION. As Section 7 of the Federal Reserve Act of December 23, 1913, provides that federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate, such exemption attaches to and follows the income derived from dividends on stock of federal reserve banks in the hands of stockholders, so that the dividends received on the stock of federal reserve banks are not subject to the income tax. Dividends paid by member banks, however, are treated like dividends of ordinary corporations. (Reg. No. 45, Article 75.)

The exemption as provided in the foregoing articles will also be found on page 347.

#### **Page 55**

**Life insurance—extent to which exempt.—**Article 72, Reg. No. 45, provides that the proceeds of life insurance policies are to be excluded from the gross income of the beneficiaries, "but not if paid to a corporation or partnership." The regulation is not in accord with the statement on page 55. The law states very specifically that the proceeds are exempt when paid to individual beneficiaries. This definitely excludes corporations but it does not exclude partnerships if the latter are held to be individuals. The trend of court decisions is not entirely uniform but in some jurisdictions it is still held that the partnership is not an entity and that in all respects a partnership must be dealt with as one or more individuals who are merely associated together for trading purposes but who are taxed as individuals and who must be sued in their individual names. The intention of the 1918 law was to broaden the provisions of the 1916 law and it is a reasonable assumption

that while there may have been some intention to restrict the exemption of corporations, there could hardly have been an intention to restrict the exemptions when the beneficiaries are taxable in their individual capacities, even though they may happen to be doing business as a partnership.

Page 60

**Income of foreign Ambassadors.**—Article 81, Reg. No. 45, provides: "The income of foreign ambassadors and ministers from investments in bonds and stocks and from interest on bank balances, and the fees of foreign consuls, are exempt from tax." It is assumed that the reason for this exemption is that theoretically the ambassadors and ministers from foreign countries when in the United States are still on foreign soil so far as other than criminal matters are concerned.

Page 63

**MUTUAL SAVINGS BANKS.**—

**REGULATION.** A Massachusetts savings bank, otherwise exempt, which establishes an insurance department under the statutes of that state, does not thereby become subject to tax upon the income received by such department. (Reg. No. 45, Article 513.)

Page 63

**FRATERNAL BENEFICIARY SOCIETIES.**—Article 514, Reg. No. 45, provides: "In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident or other benefits."

Page 63

**BUILDING AND LOAN ASSOCIATIONS.**—

**REGULATION.** . . . . The statute requires that the members of the association shall share in its profits on substantially the same footing. Subject to this requirement, it does not prevent exemption that the association issues prepaid stock entitled to a specified percentage of the profits. Where, however, the association issues paid-up stock, the holders of which are entitled to a fixed dividend and also a share in the profits with all the other holders of stock, it is not exempt. (Reg. No. 45, Article 515.)

## CEMETERY COMPANIES.—

REGULATION. A cemetery company having a capital stock represented by shares, or which is operated for profit or for the benefit of others than its members, does not come within the exempted class. A cemetery company of which all lot owners are members, issuing preferred stock entitling the holder to a semi-annual dividend of 4 per cent, and whose articles of incorporation provide that the preferred stock shall be retired at par as soon as sufficient funds are realized from sales and that all funds realized in addition thereto shall be used by the company for the care and improvement of the cemetery property, is within the exemption. (Reg. No. 45, Article 516.)

## RELIGIOUS, CHARITABLE, EDUCATIONAL, ETC., SOCIETIES.—

REGULATION. The exemption applies only to a corporation or association. It does not include the case of a trust, under which the trustee is authorized to use the trust property for religious purposes. In order to be exempt the corporation or association must meet three tests: (a) it must be organized and operated for one or more of the specified purposes; (b) it must be organized and operated exclusively for such purposes; and (c) no part of its income must inure to the benefit of private stockholders or individuals.

(1) Charitable corporations include an association for the relief of the families of clergymen, even though the latter make a contribution to the fund established for this purpose; or for furnishing the services of trained nurses to persons unable to pay for them; or for aiding the general body of litigants by improving the efficient administration of justice. Educational corporations include an association whose sole purpose is the instruction of the public, even if it merely disseminates propaganda on a single question. Thus an association inculcating prohibition or protectionist principles is exempt. The same is true of an association to promote acquaintance with the Spanish language and literature, although it has incidental amusement features; of an association to increase knowledge of the civilization of another country; and of a Chautauqua association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community and whose amusement features are incidental to this purpose. Societies designed to encourage the performance of first class orchestral music are not exempt, the purpose being merely to provide a high grade of entertainment. Scientific corporations include an association for the scientific study of law, to the end of improvement in its administration.



(2) Where a religious corporation owns a large quantity of farm land and works it, and also manufactures and sells clothing and other articles for profit, it is not operated exclusively for religious purposes and is not exempt, even though its property is held in common and its profits do not inure to the benefit of individual members of the society.

(3) It does not prevent exemption that private individuals, for whose benefit a charity is organized, receive the income of the corporation or association. The statute refers to individuals having a personal and private interest in the activities of the corporation, such as stockholders. If, however, a corporation issues "voting shares," which entitle the holders upon the dissolution of the corporation to receive the proceeds of its property, including accumulated income, the right to exemption does not exist, even though the by-laws provide that the shareholders shall not receive any dividend or other return upon their shares. (Reg. No. 45, Article 517.)

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#### CHAMBERS OF COMMERCE, ETC.—

REGULATION. A business league is an association of persons having some common business interest, which limits its activities to work for such common interest and does not engage in a regular business of a kind ordinarily carried on for profit. Its work need not be similar to that of a chamber of commerce or board of trade. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not such a league, since its members have no common business interest, and it is not exempt, even though all of its income is devoted to the purpose stated. A clearing house association, not organized for profit, no part of the net income of which inures to any private stockholder or individual, is exempt provided its activities are limited to the exchange of checks and similar work for the common benefit of its members. An association of persons who are engaged in the business of carrying freight and passengers by boats propelled by steam, which is designed to promote the legitimate objects of such business, all of the income of which is derived from membership dues and is expended for office expenses and the salary of a secretary-treasurer, is exempt from tax. An incorporated cotton exchange, whose shares carry the right to dividends, is organized for profit and is not exempt. (Reg. No. 45, Article 518.)

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#### CIVIC LEAGUES.—

REGULATION. A corporation having capital stock and possessing a charter which authorizes it to buy, improve and sell real estate is

organized for profit within the meaning of the statute and is not exempt from tax as a civic league or organization, even though it no longer exercises such powers for profit and is operated exclusively for the promotion of social welfare. (Reg. No. 45, Article 519.)

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#### CO-OPERATIVE SOCIETIES, ETC.—

REGULATION. (a) Co-operative associations, acting as sales agents for farmers or others, in order to come within the exemption must establish that for their own account they have no net income. Co-operative dairy companies not having capital stock, which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among their members upon the basis of the quantity of milk or butter fat in the milk furnished by such members, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the company will be subject to tax. A farmers' association is not exempt from taxation where in accounting to farmers furnishing produce for the proceeds of sales it deducts more than the necessary selling expenses incurred. (b) Co-operative associations acting as purchasing agents are not expressly exempt from tax and must make returns of income, but rebates made to purchasers, whether or not members of the association, in proportion to their purchases may be excluded from gross income in computing the net income subject to tax. (Reg. No. 45, Article 522.)

## CHAPTER III

### RETURNS

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#### THE ESTABLISHMENT OF THE FISCAL YEAR.—

Article 25, Reg. No. 45, apparently contemplates that the fiscal year shall be used by all persons reporting for 1918 who keep their accounts on a fiscal year basis. The article provides further:

REGULATION. . . . A taxpayer shall make his return for the taxable year 1918 on the basis of his annual accounting period (fiscal or calendar year), even though a part of such accounting period was

included in a period for which he had previously made return. Thus an individual whose accounting period ended June 30, 1918, and who had previously made a return for the calendar year 1917, should make a complete return in accordance with the provisions of the statute for the twelve months ending June 30, 1918.

There is nothing in the regulations which would seem to limit the right to report on a fiscal year basis to persons engaged in business.

Article 26 would appear to make it impossible for a taxpayer to take advantage of the intent of the law, because the regulations did not appear in time to enable a taxpayer to give notice 30 days prior to March 15, 1919, of his intention to report on a fiscal year basis. Obviously taxpayers whose fiscal years ended during one of the early months of 1918 would by this time be in default as to that part of their fiscal year which ended say prior to February 28, 1918. It would seem, however, that in order to carry out its express policy of requiring reports for taxpayers' accounting periods, the Commissioner will grant any reasonable request which will bring about the desired result, even though the time for notice of an intention to change has expired. Any taxpayer who wishes to change from a calendar year to a fiscal year basis and who desires to make the change for a part of the calendar year 1918, can probably secure permission to do so by writing to the collector.

If an individual taxpayer has never made an income tax return and wishes to establish a fiscal period other than the calendar year, permission would probably be withheld until it was shown that for the calendar year during which permission was requested there had been no net income between the first day of such calendar year and the date which the taxpayer selected for the beginning of his fiscal period. In most cases, therefore, when an individual wishes to commence to report on a fiscal year basis, it will be necessary to file a return for the fractional part of the year commencing January 1, down to the date when the new fiscal year begins.

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**ESTABLISHMENT OF THE FISCAL YEAR.**—Form 1040 was compiled to be used for the calendar year 1918 only and is not adapted to the making of returns by individuals on the fiscal year basis.

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**RETURN BY NEW CORPORATION.**—Section 226 of the law provides: "If a taxpayer making his first return for income tax keeps his accounts on the basis of a fiscal year he shall make a separate return for the period between the beginning of the calendar year in which such fiscal year ends and the end of such fiscal year."

This provision appears in the regulations under the caption "Returns when accounting period changed." It therefore does not strictly relate to the case of a new corporation which is not changing from one basis to another but which starts in business sometime during the calendar year and wishes to report on the fiscal year basis.

In answer to an inquiry as to the method of reporting by a corporation which organized on October 1, 1918, and which wished to establish September 30, 1919, as its first fiscal period, Commissioner Roper on March 12, 1919, advised as follows: "If your books are kept on basis of a fiscal year ending September thirtieth you should file your first corporate income tax return upon basis of such fiscal year ending in nineteen nineteen on or before December fifteenth, nineteen nineteen. No notice of date of close of fiscal year required." This interpretation obviates any necessity for reporting a fractional part of the year when a new corporation does not wish to do so.

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**Returns by minors.**—Article 402, Reg. No. 45, now definitely requires a return from the minor who has any taxable net income.

**REGULATION.** An individual under 21 years of age or under the statutory age of majority where he lives, whatever it may be, is required to render a return of income if he has a net income of his own of \$1,000 or over for the taxable year. If the aggregate of the net income of a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from any earnings for his own use, is at least \$1,000, a return as in the case of any other individual must be made by him or by his guardian or some other person charged with the care of his person or property for him. If, however, a minor is dependent upon his parent, who appropriates or may appropriate his earnings, such earnings are income of the parent and not of the minor for the purpose of the normal tax and surtax. In the absence of proof to the contrary a parent will be assumed not to have emancipated his minor child and must include in his return any earnings of the minor. (Reg. No. 45, Article 402.)

The foregoing regulation does not say anything about the married minor. If such minor were married, while a return might be required if his net income were \$1,000 or over, he would be entitled to the exemptions of a married person or of the head of a family.

The latter part of the article which holds that a parent will be assumed not to have emancipated his minor child is reasonable, otherwise minor children with taxable incomes might erroneously assume that they were not individually responsible for making returns and the parent in turn might assume that as the minor had a taxable income, the latter was responsible for the making of return.

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**Returns by fiduciaries.**—It should be noted that fiduciaries must make full returns of information.

**RULING.** Is any other than a return of income required of a fiduciary?

Yes. Fiduciaries come within the provisions of Section 256, of the revenue act of 1918, and will be required to render to the Commissioner of Internal Revenue a return of information, if, during the taxable year, any income has been paid to an individual, partnership, corporation, joint-stock company, etc., equal to, or in excess of \$1,000. (*Income Tax Primer*, 1919, question 106.)

It should also be noted that a fiduciary must make returns not only for the estate for which he acts but must make a personal return for the deceased.

**RULING.** Is the duly appointed administrator of an estate of a deceased person who died during the tax year required to render a personal return for and in behalf of the deceased, and also his estate?

If the net income of the deceased from January 1 of the year during which he died to the date of his death equaled or exceeded \$1,000 in the case of an unmarried person or \$2,000 in the case of a married person, the administrator should file a personal return, executed on form 1040, for and in behalf of the deceased and a return executed on the same form will also be required of him for and in behalf of the estate, if it remains in process of administration and its net income from the date of the decedent's death to December 31 not properly paid or credited to any beneficiary equals or exceeds \$1,000.

The administrator will be required to pay and will be held liable for any amount of tax which may be assessed against any such return rendered by him.

If the amount of net income properly paid or credited to any beneficiary equals or exceeds \$1,000, a separate return on form 1041 should be made covering such payments.

If any portion of the net income of an estate during the process of administration is paid or credited to a non-resident alien beneficiary, a return is required, and the normal income tax of 8 per cent is to be deducted and withheld from so much of the amount paid or credited to such beneficiaries as was not derived from dividends from corporations subject to tax or which has been subject to withholding of the normal tax at the source. A separate return on form 1040 is also required for each non-resident alien beneficiary of such estates. (*Income Tax Primer*, 1919, question 101.)

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**Returns of foreign interest and dividends.**—It should be noted that schedule G, page 2, of instructions on form 1040, calls for a separate schedule containing details of holdings of bonds of foreign countries or corporations and stock of foreign corporations separated in the proper classifications and giving the amounts of income from each.

### **Annual Returns by Partnerships and Personal Service Corporations**

The time for filing partnership returns has been extended to May 15, 1919 (T. D. 2796, February 27, 1919). The same extension of time applies to returns of partnerships having a fiscal year ended on the last day of some month other than December in the year 1918. This applies to partnerships which secured the extensions of time in which to file returns (T. D. 2804, March 13, 1919). Form 1065 revised applicable to 1918 returns has not yet been issued. This form is merely a return for information but it is of considerable importance as it specifies the shares of the earnings of partnerships and personal service corporations which are taxable to the individual partners or stockholders.

Article 624, Reg. No. 45, regarding the returns of personal service corporations is as follows:

**REGULATION.** Every personal service corporation must make a return of income, regardless of the amount of its net income. The return shall be on form 1065 (revised). It shall be made for the taxable year of the personal service corporation; that is, for its annual accounting period (fiscal year or calendar year, as the case may be), regardless of the taxable years of its stockholders. If the personal service corporation makes any change in its accounting period it shall render its return in accordance with the provisions of Section 226 of the statute and Article 431. The return of a personal service corporation shall state specifically (a) the items of its gross income enumerated in Section 213 of the statute; (b) the deductions enumerated in Section 214 of the statute, other than the deduction provided in paragraph (11) of subdivision (a) of that Section; (c) the amounts specified in subdivisions (a) and (b) of Section 216 of the statute received by the personal service corporation; (d) the amount of any income, war profits and excess profits taxes of the personal service corporation paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year; (e) the amounts distributed by the corporation during its taxable year with the dates of distribution; (f) the names and addresses of the stockholders of the corporation at the close of its taxable year and their respective shares in such corporation; (g) such facts as tend to show whether

or not the corporation is a personal service corporation; and (h) such other facts as are required by the form. A personal service corporation which makes a return for a fiscal year beginning in 1917 shall include therein all the facts required for the computation of income and excess profits taxes under title I of the revenue act of 1916, as amended by the revenue act of 1917, and under titles I and II of the revenue act of 1917.

A personal service corporation whose fiscal year ends April 30 will have made return for four months of 1918 under the excess profits tax law. It should apply for a refund of one-third of the tax paid, the receipt of which will adjust all taxes payable for the period prior to January 1, 1918. As soon as form 1065 is available the corporation should file a return for the first four months of 1918. The return for its fiscal year ending April 30, 1919, will be due on or before July 15, 1919. If the stockholders of the personal service corporation reported for the calendar year, they should file amended returns for 1918, including therein their respective shares of the earnings of the corporation for the first four months of 1918, as shown by the form 1065 and should omit therefrom the dividends, if any, received by them after January 1, 1918, from the personal service corporations, if such dividends were declared out of earnings which accrued after January 1, 1918. If the stockholders of the personal service corporation desire to make returns for a fiscal year ending April 30, they should immediately request permission to do so. Assuming that the permission is granted, they will file returns at once for their distributive shares of the corporation's earnings for the first four months of 1918, and omit any income which was received or accrued or any expenses which were paid or incurred between May 1 and December 31, 1918. On or before July 15, 1919, the individual stockholders will file individual returns, including therein their distributive shares of the earnings of the personal service corporation for the fiscal year ending April 30, 1919, together with all additional income or expenses applicable to their own fiscal periods ended same date.



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**Return by receiver of partnership.**—Article 411, Reg. No. 45, provides that “a receiver in charge of the business of a partnership shall make a return for it on form 1065 (revised).” This also would be in the form of a return of information and would not be a return on which the tax would be directly assessed. It would, however, indicate the distributive shares of the partners during the period covered by the receivership. When a receiver is appointed for a partnership the same person is usually made receiver for each of the partners.

**Page 86****Annual Returns by Corporations**

In view of the recent inability of the Treasury Department to furnish forms, the following is of interest:

**REGULATION.** Copies of the prescribed return forms will be furnished corporations by collectors. Failure on the part of any corporation liable to tax to receive a prescribed blank form will not, however, excuse it from making the return. Corporations not supplied with the proper forms should make application therefor to the collector in ample time to have their returns prepared, verified and filed with the collector on or before the last due date. Each corporation should carefully prepare its return so as fully and clearly to set forth the data therein called for. Imperfect or incorrect returns will not be accepted as meeting the requirements of the statute. In lack of a prescribed form a statement made by a corporation disclosing its gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the corporation from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form. (Reg. No. 45, Article 626.)

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**Returns by corporations.**—The following regulations cover the returns by various classes of corporations. There is no change in past procedure.

**REGULATION.** Every corporation not expressly exempt from tax and every personal service corporation must make a return of income,

regardless of the amount of its net income. In the case of ordinary corporations the return shall be on form 1120. For returns of insurance companies see Article 623; of personal service corporations see Article 624; of foreign corporations see article 625; and of affiliated corporations see Section 240 of the statute and Articles 631-638. A corporation having an existence during any portion of a taxable year is required to make a return. A corporation which has received a charter, but has never perfected its organization, and which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return so long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. A corporation which was dissolved in 1918 or 1919 prior to the enactment of the present statute is not relieved from the necessity of rendering returns thereunder for 1918 and for such portion of 1919 as elapsed before its dissolution. (Reg. No. 45, Article 621.)

#### Page 86

**Corporation defined.**—On March 17, 1919, the United States Supreme Court reversed the decision of the United States Circuit Court of Appeals in the case of *Malley v. Crocker*, which had held Massachusetts trusts to be associations. The court said: "The trust that has been described would not fall under any familiar conception of a joint-stock association, whether formed under a statute or not. . . . It seems to be an unnatural perversion of a well known institution of the law."

#### Page 87

#### Returns by receivers.—

**REGULATION.** Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on form 1120, covering each year or parts of years during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee or assignee, subject to the order of the court, such receiver, trustee or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a

receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. (Reg. No. 45, Article 622.)

### **Returns of foreign corporations.—**

REGULATION. Every foreign corporation having income from sources within the United States must make a return of income on form 1120. If such a corporation has no office or place of business here, but has a resident agent, he shall make the return. It is not necessary, however, for it to be required to make a return that the foreign corporation shall be engaged in business in this country or that it have any office, branch or agency in the United States. (Reg. No. 45, Article 625.)

**Pages 89 and 344**

**Consolidated returns.**—In connection with preparation of consolidated returns the following regulations are of interest as indicating the usual accounting procedure which is followed in the preparation of consolidated balance sheets and also set forth the requirements of the Department.

### **AFFILIATED CORPORATIONS: INVESTED CAPITAL.—**

REGULATIONS. The invested capital of affiliated corporations for the taxable year is the invested capital of the entire group treated as one unit operated under a common control. As a first step in the computation a consolidated balance sheet should be prepared in accordance with standard accounting practices, which will reflect the actual assets and liabilities of the affiliated group. In preparing such a balance sheet all intercompany items, such as intercompany notes and accounts receivable and payable, should be eliminated from the assets and the liabilities, respectively, and proper adjustments should be made in respect of intercompany profits or losses reflected in inventories which at the beginning or end of the taxable year contain merchandise exchanged between the corporations included in the affiliated group at prices above or below cost to the producing or original owner corporation. Such consolidated balance sheet will then show (a) the capital stock of the parent or principal company in the hands of the public; (b) the consolidated surplus belonging to the stockholders of the parent or principal company; and (c) the capital stock, if any, of subsidiary companies not owned by the parent or principal company, together with the surplus, if any, belonging to such minority interest. In computing consolidated invested capital the starting point is furnished by the total of the amounts shown under (a), (b) and (c) above. This total must be increased or

diminished by any adjustments required to be made under the provisions of sections 325, 326, 330 and 331 of the statute and articles 811-818, 831-869, 931-934, and 941 of the regulations, except as otherwise provided in articles 865-868. (Reg. No. 45, Article 864.)

#### AFFILIATED CORPORATIONS.—

The provision of the statute requiring affiliated corporations to file consolidated returns is based upon the principle of levying the tax according to the true net income and invested capital of a single business enterprise, even though the business is operated through more than one corporation. Where one corporation owns the capital stock of another corporation or other corporations, or where the stock of two or more corporations is owned by the same interests, a situation results which is closely analogous to that of a business maintaining one or more branch establishments. In the latter case, because of the direct ownership of the property, the invested capital and net income of the branch form a part of the invested capital and net income of the entire organization. Where such branches or units of a business are owned and controlled through the medium of separate corporations, it is necessary to require a consolidated return in order that the invested capital and net income of the entire group may be accurately determined. Otherwise opportunity would be afforded for the evasion of taxation by the shifting of income through price fixing, charges for services and other means by which income could be arbitrarily assigned to one or another unit of the group. In other cases without a consolidated return excessive taxation might be imposed as a result of purely artificial conditions existing between corporations within a controlled group. (Reg. No. 45, Article 631.)

Pages 89 and 344

#### CONSOLIDATED RETURNS.—

Affiliated corporations, as defined in the statute and in Article 633, are required to file consolidated returns on form 1120. The consolidated return shall be filed by the parent or principal corporation in the office of the collector of the district in which it has its principal office. Each of the other affiliated corporations shall file in the office of the collector of its district form 1122, along with the several schedules indicated thereon. The parent or principal corporation filing a consolidated return shall include in such return a statement specifically setting forth (a) the name and address of each of the subsidiary or affiliated corporations included in such return, (b) the par value of the total outstanding capital stock of each of such corporations at the beginning of the taxable year, (c) the par value of such capital stock held by the parent corporation or by the same interests at the beginning of the taxable year, (d) in the case of affiliated corpora-

tions owned by the same interests, a list of the individuals or partnerships constituting such interests, with the percentage of the total outstanding stock of each affiliated corporation held by each of such individuals or partnerships during all of the taxable year, and (e) a schedule showing the proportionate amount of the total tax which it is agreed among them is to be assessed upon each affiliated corporation. (Reg. No. 45, Article 632.)

#### WHEN CORPORATIONS ARE AFFILIATED.—

Corporations will be deemed to be affiliated (a) when one corporation owns directly or controls through closely affiliated interests or by a nominee or nominees substantially all the stock of the other or others, or (b) when substantially all the stock of two or more corporations is owned or controlled by the same interests. The words "substantially all the stock" shall be deemed to mean 95 per cent or more of the outstanding voting capital stock (not including stock in the treasury) at the beginning of and during the taxable year. When the stock ownership falls below 95 per cent, but is in excess of 50 per cent, a full disclosure of affiliations shall be made, and if it appears that the taxes cannot be equitably assessed in such cases on the basis of separate returns, consolidated returns may be required. The words "by the same interests" shall be deemed to mean the same individual or partnership or the same individuals or partnerships, but when the stock of two or more corporations is owned by two or more individuals or by two or more partnerships a consolidated return is not required unless the percentage of stock held by each individual or each partnership is substantially the same in each of the affiliated corporations. (Reg. No. 45, Article 633.)

#### CHANGE IN OWNERSHIP DURING TAXABLE YEAR.—

When one corporation owns substantially all the stock of another corporation at the beginning of any taxable year, but during the taxable year sells all or a majority of such stock to outside interests not affiliated with it, or when one corporation during any taxable year acquires substantially all the capital stock of another corporation with which it was not previously affiliated, a full disclosure of the circumstances of such changes in ownership shall be submitted to the Commissioner. In accordance with the peculiar circumstances in each case the Commissioner may require separate or consolidated returns to be filed, to the end that the tax may be equitably assessed. (Reg. No. 45, Article 634.)

**Pages 89 and 344**

#### CORPORATION DERIVING CHIEF INCOME FROM GOVERNMENT CONTRACTS.—

In the case of any affiliated corporation organized after August

1, 1914, and not a successor to a then existing business, 50 per cent or more of whose gross income consists of gains, profits, commissions, or other income derived from a government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive, the net income and invested capital of such corporation shall be taken out of the consolidated net income and invested capital of the group of affiliated corporations and the corporation so segregated shall be separately assessed on the basis of its own invested capital and net income, the remainder of such affiliated group being assessed on the basis of the remaining consolidated invested capital and net income. (Reg. No. 45, Article 635.)

DOMESTIC CORPORATION AFFILIATED WITH FOREIGN CORPORATION.—

A domestic corporation which owns a majority of the stock of a foreign corporation shall not be permitted or required to include the net income or invested capital of such foreign corporation in a consolidated return, but for the purpose of Section 238 of the statute a domestic corporation which owns a majority of the voting stock of a foreign corporation shall be entitled to credit in respect of any income, war profits or excess profits taxes paid (but not including taxes accrued) by such foreign corporation during the taxable year to any foreign country or to any possession of the United States upon income derived from sources without the United States in an amount equal to the proportion which the amount of any dividends (not deductible under Section 234) received by such domestic corporation from such foreign corporation during the taxable year bears to the total taxable income of such foreign corporation upon or with respect to which such taxes were paid. But in no such case shall the amount of the credit for such taxes exceed the amount of such dividends (not deductible under Section 234) received by such domestic corporation during the taxable year. A domestic corporation seeking such credit must comply with those provisions of subdivision (a) of Article 383 which are applicable to credits for taxes already paid, except that in accordance with Article 611 the form to be used is form 1118 instead of form 1116. (Reg. No. 45, Article 636.)

CONSOLIDATED NET INCOME OF AFFILIATED CORPORATIONS.—

Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions, the consolidated taxable net income shall be the combined net income of the several corporations consolidated, except that the net income of corporations coming within the provisions of Article 635 shall be excluded. In respect of

the statement of gross income and deductions and the several schedules required under form 1120, a corporation filing a consolidated return is required to prepare and file such statements and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited. (Reg. No. 45, Article 637.)

**Pages 89 and 344**

**DIFFERENT FISCAL YEARS OF AFFILIATED CORPORATIONS.—**

In the case of all consolidated returns, consolidated invested capital must be computed as of the beginning of the taxable year of the parent or principal reporting company and consolidated income must be computed on the basis of its fiscal year. Whenever the fiscal year of one or more subsidiary or other affiliated corporations differs from the fiscal year of the parent or principal corporation, the Commissioner should be fully advised by the taxpayer in order that provision may be made for assessing the tax in respect of the period prior to the beginning of the fiscal year of the parent or principal company. (Reg. No. 45, Article 638.)

The foregoing regulations refer to consolidated returns as covering the operations theoretically of a single business enterprise. It should be kept in mind that the law requires that corporations which are affiliated shall make consolidated returns without any regard whatever to the character of business conducted by the various corporations which are owned by the same interests. Therefore, if a holding company owns the stock of a street railway and also owns the stock of an oil company, or if corporations conducting any such dissimilar businesses are controlled by the same interest, Section 240 (a) requires that consolidated returns be made.

It will be noted that the holding or principal corporation makes return on form 1120 and each of the other affiliated corporations uses form 1122. It should be noted that when stock ownership is below 95 per cent but in excess of 50 per cent, a disclosure of affiliations shall be made. After such disclosure the regulations would seem to indicate that a consolidated return will or will not be required, based on the decision of the Commissioner. The Commissioner must be guided by a reasonable interpretation of the phrase in the law "owns or con-

trols substantially all the stock." The ownership of 51 per cent of the stock of a subsidiary might be sufficient to control the subsidiary but if the remaining 49 per cent were held by entirely different interests, it is not likely that income or expenses could be shifted to the detriment of the government.

**Pages 89 and 344**

**WHEN FISCAL YEARS OF HOLDING AND AFFILIATED COMPANIES DO NOT COINCIDE.**—It sometimes happens that a holding company has established a fiscal year which differs from that of one or more of its subsidiaries. This usually happens only in the case of newly formed holding companies and rarely continues for more than a short period of time, as it is practically impossible to prepare a consolidated balance sheet or earnings statement unless the fiscal periods of all the companies are exactly the same. The following decision permits amended returns to be filed in order that the operations of the whole group may be reduced to a common basis.

**REGULATION.** In any case where an affiliated corporation has made its income tax return on the basis of a taxable year different from that on the basis of which a consolidated excess profits tax return in which it is included has been made under the provisions of Articles 77 and 78 of Regulations No. 41 and of T. D. 2662, an amended income tax return may be made on the basis of the same taxable year as the consolidated return, even though notice was not given within the time prescribed in Articles 211 to 215, inclusive, of Regulations No. 33 (revised) or in Regulations No. 45. In such a case an amended income tax return shall also be made for any unaccounted for portion of the corporation's taxable year.

Collectors of Internal Revenue may accept amended returns made under the provisions of this Treasury Decision. (T. D. 2805, March 14, 1919.)

**Page 90**

**CONSOLIDATED RETURNS OF NET INCOME.**—Section 240 (a) of the law specifically provides that all taxes shall be computed and determined upon the basis of the consolidated return. It sometimes happens that earnings of a holding company and its subsidiaries are not sufficient within certain



periods to cover the dividends paid during such periods. In computing invested capital such a contingency might result in the reduction of the invested capital of one of the group. By consolidating the net income of all affiliated corporations, there will be no reduction in the invested capital after the expiration of 60 days following the end of the taxable year, provided the combined earnings of the group are sufficient to pay the combined dividends.

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### **Extensions of Time for Filing Returns**

**REGULATION.** By Treasury Decision 2796, the time for filing certain classes of returns which are not the basis for an assessment of tax, was extended to May 15, 1919, and the time for filing returns by partnerships and corporations having a fiscal year ended on the last day of some month (other than December) in the year 1918, and which had secured extensions of time in which to file returns, such extensions not having expired, was further extended to March 15, 1919.

In view of the fact that necessary forms are not yet available, a further extension to May 15, 1919, is hereby granted all such partnerships. Individual members of such partnerships, as in the case of partnerships filing on the basis of the calendar year, will be required to include in their individual returns their distributive shares of the earnings of such partnerships (ascertained or estimated) and pay at least one-fourth of the tax due on March 15. (T. D. 2804, March 13, 1919.)

**REGULATION.** Because of the fact that it will be impossible to put into the hands of taxpayers residing or located in the Territory of Alaska the blank forms and instructions prescribed by this department for the use of taxpayers in making returns pursuant to the new revenue act in time for such returns to be filed on or before the due date—March 15, 1919—an extension of time to June 15, 1919, is hereby granted to all taxpayers living or residing temporarily in the Territory of Alaska. This extension shall not be construed as extending the payment of the second instalment due June 15, 1919, and subsequent instalments, therefore two instalments will be due June 15, 1919. (T. D. 2810, March 21, 1919.)

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The general extension of time to April 29, 1919, to all individuals and corporations who made payment of one-fourth

of the amount of their tax on or before March 15, 1919, was predicated upon the theory that a tentative return had been made and that in effect no extension of time was granted but the taxpayer was merely given 45 days within which to complete the tentative return. This so-called extension should not be confused with the 30-day extension which *collectors* are in all cases empowered to grant whenever in their judgment such time is actually required for the making of an accurate return. This applies only in cases of sickness or absence. If before the end of the 30 days it is found that an accurate return cannot be made, an appeal for a further extension is not made to the collector but to the Commissioner, who will not grant the further extension unless a clear showing is made that a complete return cannot be made by the end of the 30-day period. The Commissioner will grant no further extension thus requested beyond the original due date of the second instalment of the tax, which date in the case of returns for the calendar year 1918 would be June 15, 1919.

The foregoing provisions are, however, very considerably modified by the further statement in the regulations that if a complete return cannot be made at that time (June 15), the facts must be submitted to the Commissioner for further action. It is entirely reasonable that all taxpayers' returns which can be filed within the time provided by law should be filed without delay. It is, however, important to bear in mind that Section 227 (a) of the law specifically empowers the Commissioner to grant extensions of time up to six months. When taxpayers actually need the time they get it. As the Commissioner is required to administer the law equitably and cannot penalize taxpayers who use due diligence in attempting to comply with the law, the principal difficulty occurs when taxpayers neglect to apply in advance for extensions of time. When a taxpayer applies for a 60-day extension and at the end of 62 days requests further time, it is entirely reasonable for the Commissioner to notify such taxpayer that the

penalties for failure to file the return will be imposed, unless good cause to the contrary is shown. If a few days prior to the expiration of the 60-day period the taxpayer were to inform the Commissioner that the return would not be ready by the due date, that the utmost expedition had been shown in an attempt to prepare it and that a further period of time was required, the extension would certainly be granted.

The Commissioner has stated that he proposes "to employ every means available so that the scales of justice may be held evenly in deciding each case." It would be absurd to impose the same conditions upon all taxpayers alike. The individual and corporation with no special problems can readily make returns within 75 days after the end of their taxable years. On the other hand there are corporations with ramifications extending all over the world which have never before or since the existence of the federal income tax laws been able to close their books within a 75-day period. The Department has never dealt harshly with the latter class of taxpayers. It does, however, very properly require that when additional time is required, it shall be asked for in due season and sound reasons given for the request.

Page 97

**When taxpayers live abroad.**—Section 227 (a) of the law provides that the six months' limitation does not cover the case of taxpayers who are abroad. American citizens residing abroad, who because of war conditions have not been able to file their returns for past years, may take advantage of this provision and if good cause is shown, will secure the necessary permission. (See T. D. 2581, page 643.)

Page 98

**Extension of time for filing 1919 returns.—**

REGULATION. In view of the delay in the final passage of the revenue act of 1918 and of the preparation of the forms required thereunder, an extension of time to include May 15, 1919, is hereby granted for the filing of returns of information (forms 1099 and 1096), fidu-

ciary returns (form 1041), annual withholding returns (form 1042, accompanied by form 1098, and form 1013) returns of partnerships which are required to file returns on the calendar year basis, and all other returns which are not the basis for the assessment of the tax.

This decision shall not be construed as relieving taxpayers from filing returns which serve as a basis for assessment, even though the person making the return is not taxable thereon, nor as relieving beneficiaries, partners and stockholders of personal service corporations from including in their personal returns their distributive share of the income accruing to the trust or estate or the partnership or personal service corporation, whether distributed or not.

Partnerships and corporations having a fiscal year ending in 1918 which have secured extensions of time which have not expired are hereby granted an extension of time to March 15, 1919, for the filing of such returns. When the returns are filed, two forms should be used and two computations made, one showing on the return form used for 1917 the tax calculated on the whole income for the entire period under the provisions and at the rates prescribed by the act of September 8, 1916, and the act of October 3, 1917, the other showing on the form for 1918 the tax on the whole income for the entire period, calculated under the provisions and at the rates prescribed by the revenue act of 1918. The tax due will be the sum of so many twelfths of the first amount as there are months in 1917 covered by the return and of the second amount as there are months in 1918.

In view of the disturbed conditions abroad and the consequent interference with the usual channels of communication, an extension of time for filing returns of income for 1918 and subsequent years is hereby granted in the case of alien individuals actually living beyond the boundaries of the United States and corporations, or their proper representatives in the United States, and of American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States, for such period as may be necessary, not exceeding 90 days after proclamation by the President of the end of the war with Germany. In all such cases an affidavit must be attached to the return, stating the causes of the delay in filing it, in order that the Commissioner may determine whether the failure to file the return in time was due to a reasonable cause and not to wilful neglect. If the showing justifies the conclusion that the failure to file the return in time was excusable, no penalty by way of addition to the tax will be imposed, except interest as provided by the statute. (T. D. 2796, February 27, 1919.)

**ORIGINAL**

Form 1040 T—UNITED STATES INTERNAL REVENUE SERVICE

**TENTATIVE RETURN AND ESTIMATE**

OF

**INDIVIDUAL INCOME TAX FOR 1918**

AND

**REQUEST FOR EXTENSION OF TIME FOR FILING RETURN**

**THIS FORM WITH  
DUPLICATE AND  
REMITTANCE  
COVERING  
ONE-FOURTH  
OF ESTIMATED TAX  
MUST REACH THE  
COLLECTOR'S OFFICE  
ON OR BEFORE  
MARCH 15, 1919.**

PRINT BELOW TAXPAYER'S NAME AND ADDRESS

Do not write in this space

**AMOUNT PAID**

\$  
(Cashier's Stamp)

Cash or draft.....  
Money order.....  
Currency or coin.....  
Certificate of indebtedness.....

Date..... No.....  
(To be entered by taxpayer.) (To be entered by Collector.)

Collector of Internal Revenue,

The amount stated below is remitted herewith in payment of not less than one-fourth of the estimated amount of the income tax for 1918 of the individual whose name and address appear at the head of this form.

An extension of ..... days in the time allowed for filing a completed return is requested.

It is not possible to file a completed return on or before March 15, 1919, for the following reasons:

Estimated amount of tax..... \$.....  
Amount of remittance herewith:

Cash or draft.	Money order.	Currency or coin.	Certificate of indebtedness.	Total.
\$.....	\$.....	\$.....	\$.....	\$.....

**AFFIDAVIT**

I SWEAR (or affirm) that the foregoing is a fair estimate of the total amount of the income tax for 1918 of the individual whose name and address appear at the head of this form, and that the above-stated reasons why a completed return can not be filed on or before March 15, 1919, are true.

Sworn to and sub-  
scribed before me } this..... day of....., 19.....

(Signature of individual or agent.)

(Name of officer.)

2-5881

Official capacity.)

(Address of individual or agent.)

**DUPLICATE**  
(to be sent to Collector with original)

**THIS FORM  
DULY APPROVED  
BY THE  
COLLECTOR MUST  
ACCOMPANY  
THE TAXPAYER'S  
COMPLETED  
RETURN  
WHEN FILED**

Form 1040 T—UNITED STATES INTERNAL REVENUE SERVICE

**TENTATIVE RETURN AND ESTIMATE**

OF  
**INDIVIDUAL INCOME TAX FOR 1918**  
AND  
**REQUEST FOR EXTENSION OF TIME FOR FILING RETURN**

PRINT BELOW TAXPAYER'S NAME AND ADDRESS

**PENALTIES**

For Making False or  
Fraudulent Returns.

Not exceeding \$10,000  
or not exceeding one  
year's imprisonment,  
or both, in the dis-  
cretion of the court,  
and, in addition, 50  
per cent of the tax  
evaded.

For Failing to Make  
Returns on Time.

Not more than \$1,000,  
and, in addition, 25  
per cent of the  
amount of tax due.

Date..... No.....  
(To be entered by taxpayer.) (To be entered by Collector.)

*Collector of Internal Revenue,*

The amount stated below is remitted herewith in payment of not less than one-fourth of the estimated amount of the income tax for 1918 of the individual whose name and address appear at the head of this form.

An extension of ..... days in the time allowed for filing a completed return is requested.

It is not possible to file a completed return on or before March 15, 1919, for the following reasons:

Estimated amount of tax..... \$.....  
Amount of remittance herewith:

Check or draft.	Money order.	Currency or coin.	Certificates of indebtedness.	Total.
\$.....	\$.....	\$.....	\$.....	\$.....

**COLLECTOR'S APPROVAL**

In consideration of the filing of this tentative return and the payment of not less than one-fourth of the estimated amount of the tax, and for the reasons stated above, the time for filing the completed return of the taxpayer whose name and address appear at the head of this form is hereby extended, by authority of the Commissioner of Internal Revenue, until.....

If the remittance accompanying this tentative return exceeds one-fourth of the tax as computed on the completed return, the excess will be credited against the balance remaining to be paid. If the remittance is less than one-fourth of the tax, the balance due, with interest at the rate of six per cent per annum from March 15, 1919, must accompany the completed return. If the amount paid exceeds the total tax as shown by the completed return, the excess will be refunded.

Date..... *Collector of Internal Revenue.*

2-5591

..... District of.....

ORIGINAL

THIS FORM WITH  
DUPLICATE AND  
REMITTANCE  
COVERING  
ONE-FOURTH  
OF ESTIMATED TAX  
MUST REACH THE  
COLLECTOR'S OFFICE  
ON OR BEFORE  
MARCH 15, 1919.

Form 1031 T—UNITED STATES INTERNAL REVENUE SERVICE

**TENTATIVE RETURN AND ESTIMATE  
OF  
CORPORATION INCOME AND PROFITS TAXES**  
AND  
**REQUEST FOR EXTENSION OF TIME FOR FILING RETURN**

Do not write in this space

**AMOUNT PAID**  
\$ .....  
(Cashier's Stamp)

PRINT BELOW TAXPAYER'S NAME AND PRINCIPAL PLACE OF BUSINESS

Check or draft .....  
Money order .....  
Currency or coin .....  
Certificates of indebtedness .....

Date ..... No. ....  
(To be entered by taxpayer.) (To be entered by Collector.)

Collector of Internal Revenue,

The amount stated below is remitted herewith in payment of not less than one-fourth of the estimated amount of the income, war-profits, and excess-profits taxes for the year ended ..... of the corporation whose name and address appear at the head of this form.

An extension of ..... days in the time allowed for filing a completed return is requested.

It is not possible to file a completed return on or before March 15, 1919, for the following reasons:

**NOTE.**—A parent company may make a tentative return and pay the first installment of the tax on behalf of all its subsidiaries without apportioning the tax among them until the completed return is filed.

Estimated amount of tax ..... \$ .....

Amount of remittance herewith:

Check or draft.	Money order.	Currency or coin.	Certificates of indebtedness.	Total.
\$ .....	\$ .....	\$ .....	\$ .....	\$ .....

**AFFIDAVIT**

The undersigned, president and treasurer, respectively, of the corporation whose name and address appear at the head of this form, being severally duly sworn, each for himself deposes and says that the foregoing is a fair estimate of the total amount of the income, war-profits, and excess-profits taxes of the said corporation for the period stated above, and that the above-stated reasons why a completed return can not be filed on or before March 15, 1919, are true.

Sworn to and sub- scribed before me) this ..... day of ....., 19....

(President.)

(Name of officer.)

(Treasurer.)

2-5601

(Official capacity.)

1010

**DUPLICATE**  
(to be sent to Collector with original)

**THIS FORM  
DULY APPROVED  
BY THE  
COLLECTOR MUST  
ACCOMPANY  
THE TAXPAYER'S  
COMPLETED  
RETURN  
WHEN FILED**

Form 1031 T—UNITED STATES INTERNAL REVENUE SERVICE

**TENTATIVE RETURN AND ESTIMATE  
OF  
CORPORATION INCOME AND PROFITS TAXES  
AND  
REQUEST FOR EXTENSION OF TIME FOR FILING RETURN**

PRINT BELOW TAXPAYER'S NAME AND PRINCIPAL PLACE OF BUSINESS

**PENALTIES**

**For Making False or  
Fraudulent Return.**

Not exceeding \$10,000  
or not exceeding one  
year's imprisonment,  
or both, in the dis-  
cretion of the court,  
and, in addition, 50  
per cent of the tax  
evaded.

**For Failing to Make  
Return on Time.**

Not more than \$1,000,  
and, in addition, 25  
per cent of the  
amount of tax due.

Date..... No.....  
(To be entered by taxpayer) (To be entered by Collector)

Collector of Internal Revenue,

The amount stated below is remitted herewith in payment of not less than one-fourth of the estimated amount of the income, war-profits, and excess-profits taxes for the year ended..... of the corporation whose name and address appear at the head of this form.

An extension of ..... days in the time allowed for filing a completed return is requested.

It is not possible to file a completed return on or before March 15, 1919, for the following reasons:

**NOTE.**—A parent company may make a tentative return and pay the first installment of the tax on behalf of all its subsidiaries without apportioning the tax among them until the completed return is filed.

Estimated amount of tax..... \$.....

Amount of remittance herewith:

Check or draft.	Money order.	Currency or coin.	Certificate of indebtedness.	Total.
\$.....	\$.....	\$.....	\$.....	\$.....

**COLLECTOR'S APPROVAL**

In consideration of the filing of this tentative return and the payment of not less than one-fourth of the estimated amount of the tax, and for the reasons stated above, the time for filing the completed return of the taxpayer whose name and address appear at the head

of this form is hereby extended, by authority of the Commissioner of Internal Revenue, until.....

If the remittance accompanying this tentative return exceeds one-fourth of the tax as computed on the completed return, the excess will be credited against the balance remaining to be paid. If the remittance is less than one-fourth of the tax, the balance due, with interest at the rate of six per cent per annum from March 15, 1919, must accompany the completed return. If the amount paid exceeds the total tax as shown by the completed return, the excess will be refunded.

Date.....

Collector of Internal Revenue.

2-3601

..... District of.....



**Taxpayers who did not make tentative returns on March 15, 1919.**—It is stated that many taxpayers neglected to pay the first instalment due March 15, 1919, and thereby lost the privilege of the 45-day extension of time within which to complete their returns and also thereby lost the privilege of paying their tax in four instalments. The Commissioner on March 17, 1919, announced that the privilege of paying in instalments was irrevocably lost, as the law [Section 250 (a)] provides that the first instalment must be paid at the time fixed by law for filing the return unless an extension has been granted and further states that if any instalment is not paid when due the whole amount of tax unpaid shall become due and payable upon notice and demand by the collector. The Commissioner, however, announced that some degree of leniency would be granted to those who have some legitimate reason why they failed to file their returns when they were due. This further statement was made:

Revenue collectors will accept all delinquent returns presented after March 15, and deposit any payment made therewith. Under law failure to make first payment by March 15 automatically makes the whole tax payable immediately. Taxpayers filing income returns subsequent to March 15, therefore, must pay in full, but if the taxpayer submits a partial payment he will be notified of the balance due later in the regular procedure of listing and sending notices. In reference to the penalty of 25 per cent additional tax for all delinquents, the policy will be to proceed sympathetically in accordance with the regulations permitting the taxpayer, if he desires, to file an affidavit within ten days explaining the cause of delinquency.

In another official statement the policy of the Department is more definitely explained:

**SPECIFIC PENALTY WILL NOT BE ASSERTED IF DELINQUENT RETURNS ARE FILED BY MAY 1, OR BY MAY 15, 1919.**—

In view of the delay in the final passage of the revenue act of 1918 and the short period allowed for filing returns thereunder, it has been decided that if a return is filed on or before May 1, 1919, by an

individual, partnership or corporation under the provisions of such act, the specific penalty of \$1,000 will not be asserted.

Where returns of income are filed after the date mentioned above or where returns of information at the source are filed after May 15, 1919, the specific penalty will be asserted unless it can be shown that the delay was due to a reasonable cause, and offers in compromise will be accepted in the minimum amounts stated below:

Delinquent returns of income by individuals .....	\$5.00
Delinquent returns of income by corporations .....	10.00
Delinquent returns of information .....	5.00

Of course it must be borne in mind that the above does not relate to cases where there is evidence of wilful intent or hostility toward the administration of the law. Such cases will be taken care of in the same manner as heretofore. (Mim. 2077, signed by Commissioner Daniel C. Roper, and dated March 13, 1919.)

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#### Examinations to Ascertain Correctness of Returns.—

On March 10, 1919, the Commissioner issued an appeal to taxpayers, asking the support of the honest man to "aid the Commissioner in bringing into camp the tax slackers." It has been stated that the greatly enlarged staff of the Commissioner has formulated plans for going after every individual who from outside appearances should have a taxable income, but who has not filed any return at all or whose return as filed does not indicate the net income which such person would reasonably be supposed to have. In other words, it will be assumed that a person who is living at the rate of, say, \$10,000 a year, will have a net income of at least that much and it is proposed to examine books and records of all such persons.

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#### USE OF RETURNS IN LEGAL PROCEEDINGS.—

REGULATION. If the return of a corporation is desired to be used in any legal proceedings other than those to which the United States is a party, or to be used in any manner by which any information contained in the return could be made public, the application for permission to inspect such return or to furnish a certified copy thereof shall be referred to the Attorney General, and if recommended by him

transmitted to the Secretary of the Treasury. (T. D. 2016, April 18, 1914, approved by the President July 28, 1914.)

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#### INSPECTION OF RETURNS OF CORPORATIONS.—

**REGULATION.** The returns of the following corporations shall be open to the inspection of any person upon written application to the Secretary of the Treasury, which application shall set forth briefly and succinctly all facts necessary to enable the Secretary to act upon the request: (a) the returns of all companies whose stock is listed upon any duly organized and recognized stock exchange within the United States, for the purpose of having its shares dealt in by the public generally; (b) all corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale. In case of doubt as to whether any company falls within the classification above, the person desiring to see such return should make application, supported by advertisements, prospectus, or such other evidence as he may deem proper to establish the fact that the stock of such corporation is offered for general public sale. Returns can be inspected only in the office of the Commissioner of Internal Revenue, in Washington, D. C. In no case shall any collector, or any other internal revenue officer outside of the Treasury Department in Washington, permit to be inspected any return or furnish any information whatsoever relative to any return or any information secured by him in his official capacity relating to such return, except in answer to a proper subpoena, in a case to which the United States is a party. (T. D. 2016, April 18, 1914, approved by the President July 28, 1914.)

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**The 50 per cent penalty.**—In view of the notice by the Commissioner that “tax slackers” are to be severely dealt with, it should be noted that in addition to all other penalties there will be added to the tax an additional 50 per cent thereof. As to what constitutes a false return will depend on the circumstances of each case, but it is reasonable to suppose that the wide publicity during the last year given to all income tax matters will put the burden of proof upon every citizen who makes an understatement and when it is found that there has been failure to report income it will be much more difficult than heretofore to claim ignorance of the law.

**Compromise of taxes and penalties.**—It would appear from the regulations that the power of the Commissioner to compromise covers all amounts due for taxes and penalties.

**REGULATION.** The Commissioner, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal revenue laws instead of commencing suit thereon, and with the advice and consent of the Secretary and the recommendation of the Attorney General may compromise any such case after suit thereon has been commenced by the United States. Accordingly, the power to compromise extends to (a) both civil and criminal cases; (b) cases whether before or after suit; and (c) both taxes and penalties. Refunds can not be made of accepted offers in compromise in cases where it is subsequently ascertained that no violation of law was involved. See further Sections 3229 and 3469, and Sections 5292 and 5293 (as amended by the act of February 27, 1877), of the revised statutes. (Reg. No. 45, Article 1011.)

For announced compromise for failure to file returns, etc., see page 1013.

A letter, similar in content to the following, suitably modified if the delinquent was a corporation, has been used in the past by the collectors in charging taxpayers with delinquency and in notifying them of their privilege to submit offers in compromise.

Sir: Your return of net income was not received in this office until . . . . ., thereby involving you in liability to a specific penalty of not less than \$20.00, or more than \$1,000, under the act of . . . . ., in addition to the 50 per cent additional tax which will be assessed and collected.

The provisions of the act are mandatory, and no excuse or explanation can be accepted, except a showing that a complete or tentative return was in fact mailed in time to have reached this office, or a Deputy Collector, in the ordinary course of business on or before March 1, . . . . .

However, before instituting proceedings in court for the imposition of the specific penalty, I am directed to call your attention to the provisions of Section 3229, revised statutes, which reads in part as follows:

“The Commissioner of Internal Revenue with the advice and consent of the Secretary of the Treasury, may compromise any

civil or criminal case arising under the internal revenue laws instead of commencing suit thereon, . . . ."

Should you desire to take advantage of your privilege under this section and to submit an offer in compromise, the amount offered should be forwarded promptly to *this office* in the form of cash, postal money order, or certified check which can be cashed without cost, payable to my order, accompanied by an affidavit substantially in the following form:

"To the Commissioner of Internal Revenue:

I hereby solemnly swear (or affirm) that my delinquency in filing return of net income as required by the act of . . . . ., was not due to any intent to violate the law or evade taxation, but was due to (here insert, concisely and clearly, the reason for delay).

Desiring to compromise my liability I hereby tender the sum of \$ . . . . ., which I request be accepted in compromise of the specific penalty only."

To be signed and sworn to before a deputy collector, notary, or other officer authorized to administer oaths.

This affidavit will then be forwarded by me, together with the sum offered, to the Commissioner for consideration, and you will be notified by him of his acceptance or rejection of your proposal. In the latter event, you may increase your offer, if you so desire.

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**Interest on penalties.**—It should be noted that the specific penalties, that is, those of not more than \$10,000, are collectible only by suit. What are known as *ad valorem* penalties are assessed and collected as a part of the tax, increase tax accordingly and interest thereon commences to run on the increased amount.

**REGULATION.** A penalty of not more than \$1,000 attaches for failure punctually to make a required return, whether of income, withholding or information, or to pay or collect a required tax. If the failure is willful, however, or an attempt is made to defeat or evade the tax, the offender is liable to imprisonment and to a fine of not more than \$10,000 and costs. See also the act of July 5, 1884. In addition to these specific penalties *ad valorem* penalties are imposed in various cases. An *ad valorem* penalty is assessed and collected as a part of the tax, while a specific penalty is recoverable only by suit. (Reg. No. 45, Article 1041.)

**When specific penalties will not be sued for.**—In view of the extraordinary conditions now existing it is believed by some that many taxpayers have subjected themselves to penalties. Under the circumstances it may be of interest to reproduce instructions to collectors regarding the imposition of the specific penalties and the attempt to recover same by suit.

**RULING.** Liability to specific penalty attaches upon all delinquent returns and is recoverable by suit. By Section 3214 R. S. the Commissioner of Internal Revenue may or may not institute suit. It has been decided not to institute suit nor to assert specific penalty in certain cases. The assertion of specific penalty does not depend upon the fact of whether or not the 50 per cent addition to tax has been assessed. In some cases where the 50 per cent addition to tax must be assessed because the return was filed after notice from the collector, the specific penalty will not be asserted. It will not be asserted, regardless of whether the 50 per cent addition to tax has been assessed, in cases falling under any of the following designations:

1. Extension granted. Where a return is filed within the thirty-day period of extension granted by the collector or within a further period of extension granted by the Commissioner of Internal Revenue, as provided by Section 14 (c) of the act of September 8, 1916.

2. Return on time. Specific penalty will not be asserted upon an amended return provided the original return was filed within the prescribed time.

3. Mailed in time. Where an affidavit is filed satisfactorily establishing that the return was placed in the mails in ample time to reach the collector's office in ordinary course of mails before the close of business on the final day for filing.

4. Tentative return. Where an informal return was filed within the time prescribed. The return of a parent company including therein the income of a subsidiary company will be accepted as a tentative return of the subsidiary company if the fact is stated that the tentative return includes the income of the subsidiary.

5. Filed in wrong district. Where the return was filed in some other collection district within the prescribed time.

6. Net income under \$3,000. Where it develops that the net income of an individual for 1913, 1914, 1915 or 1916 was less than \$3,000, or under the act of October 3, 1917, for 1917, etc., less than \$1,000 or \$2,000.

7. Erroneous information. Where the delinquency is alleged to be due to erroneous or misleading information given by officials or employees of the Internal Revenue Service and there is no evidence in conflict therewith.

8. Organization incomplete. Where it is established that the organization of a corporation, joint-stock company or association, or insurance company was not completed until after the expiration of the period for which the return should have been filed.

9. Death. Where by reason of the death of an individual his return for the year or portion of the year prior to his death is not filed within the time prescribed. The death of a delinquent abates liability to specific penalty. An administrator or executor is charged with the duty of rendering a return for the decedent, and if he is appointed in ample time to make the return prior to March 1 and fails to do so, he should be charged as delinquent and the specific penalty should be asserted against him. The administrator or executor will not be relieved from specific penalty unless the return is made within a reasonable time after his appointment.

10. Severe illness or unavoidable absence. Where it is clearly established that the delinquency in the filing of a return of an individual or of a corporation within the time prescribed was due to severe illness of the individual or of an officer of a corporation whose duty it was to prepare or sign the return, or to unavoidable absence from place of business or place of abode.

11. Absence from the United States. Where it appears that the filing of a return within the time prescribed was rendered impossible by reason of absence from the United States. Delinquency beyond the period of extension which may be granted by the Commissioner of Internal Revenue will not be excused under this heading.

12. Military or naval service of United States. Where the delinquency of an individual was occasioned by service in the military or naval forces of the United States.

13. Not organized for profit. Comprehends numerous small corporations not organized primarily for profit, such as local telephone companies, co-operative purchasing societies, etc., concerning whose liability under the law to make a return there may have been a reasonable doubt.

14. Inactive corporations. Those which transacted no business and had no income during the return year.

15. Fiscal year. Corporations which have established a fiscal year in the manner prescribed by law which file a return on or before the first day of the third month following the close of the fiscal year.

16. Assigned. Where corporations have made an assignment on account of insolvency and do not intend again to engage in business.

17. Insolvent. Where the assets of a corporation are insufficient for the payment of its debts and the corporation has ceased to do business.

18. Charter forfeited. Where, prior to the date when the return

was due, the charter of a corporation is forfeited on account of non-compliance with state laws. It must be clear, however, that business in the name of the corporation was suspended at the time of such forfeiture. If business was continued under the same name, the concern will be held to be an association and the same liabilities will attach as if the charter had not been forfeited.

19. Defunct. Where corporations are out of business, have no assets, maintain no organization, and the purpose for which organized has been abandoned.

20. Dissolved. Where all the assets of a corporation have been distributed.

21. Sale. Where corporations have disposed of all their assets and property by sale to other corporations, firms, or individuals and business is no longer carried on under their charters.

22. Consolidated, merged or succeeded. Where corporations have terminated their existence as represented by these terms and it appears that no assets or property remain in the name of the retiring corporation.

23. No assets. Includes all corporations having no assets from which to submit an offer in compromise.

In cases not included in any of the above classes, the specific penalty will be asserted, and if the delinquency was not due to an intention to delay the administration of the law the minimum amount which will be accepted in compromise is as follows:

\$5.00 in the case of an individual or withholding agent.

\$10.00 in the case of a corporation, joint-stock company or association, or insurance company.

These amounts will be considered insufficient and will not be accepted in any case where it appears that a taxpayer was intentionally violating the provisions of law, and purposely delaying the filing of the returns. In all cases where revenue agents or other examining officers discover that any individual has an appreciable taxable income and the examining officer is of the opinion that the individual knew or should have known that he was required to make a return, he should make a recommendation as to the minimum amount which should be accepted as an offer in compromise, and where the intent to evade tax is plain he should recommend prosecution. Special attention should be called to cases of individuals having a taxable income who have failed to file returns for a number of years.

In the case of delinquent returns filed pursuant to the provisions of Section 2 of the act of October 3, 1913, specific penalty will not be asserted if the case comes under any of the above designations, nor against taxpayers or withholding agents specifically relieved from specific penalty by the proviso contained in Section 18 of the income



tax law of September 8, 1916, as amended by Section 1209 of the act of October 3, 1917, which reads as follows:

"PROVIDED, That where any tax heretofore due and payable has been duly paid by the taxpayer, it shall not be re-collected from any withholding agent required to retain it at its source, nor shall any penalty be imposed or collected in such cases from the taxpayer, or such withholding agent whose duty it was to retain it, for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment."

Furthermore, specific penalty will not be asserted against taxpayers delinquent in filing returns for 1913, nor against corporations, joint-stock companies or associations or insurance companies delinquent in filing returns for prior years, unless it appears beyond a reasonable doubt that there was an intent on the part of the delinquent to violate the provisions of law. The specific penalty cannot in any case be asserted after five years from date of delinquency, and no recommendation with respect to penalty in such cases need be made. The minimum amounts mentioned above will be accepted in compromise of liability to specific penalty for each of the years 1914 and 1915, as well as for 1916, except where there was an apparent intent to violate the taxing act, in which case the offer must be increased in a substantial amount.

In the case of every delinquent return, the collector should secure a statement from the delinquent of the cause of delinquency, which should be attached to and made a part of the return, together with delinquent card. If the delinquent is not relieved from specific penalty by clearly falling within one of the classes enumerated in this mimeograph letter, or if he fails, upon request, to file a statement of the reason for delinquency, the specific penalty should be promptly asserted and the delinquent advised of his privilege to submit an offer in compromise. If the collector is of the opinion that the delinquent should be relieved from the specific penalty under the provisions of this mimeograph letter, he should note on the delinquent card "Relieved under Mim. No. 1675."

In all cases of delinquency discovered by revenue agents and other examining officers, if the delinquency falls within a period for which the penalty can be asserted, such officers should secure from the delinquent a sworn statement setting forth the reason for delinquency. This statement should be attached to the return forwarded to the collector. The examining officer should state in his report the alleged reason for delinquency and if he is of the opinion that the minimum amount should not be accepted as an offer in compromise of liability to specific penalty, he should make a recommendation as to the mini-

mum amount which should be accepted. Consideration will be given such recommendation by this office in accepting an offer in compromise. In forwarding offers in compromise on form 656 collectors should call attention to revenue agents' reports, if any, in which the non-acceptance of the minimum amount as an offer in compromise is recommended. The statement or affidavit attached to the return setting forth the reason for delinquency is not in lieu of the affidavit required to be attached to form 656. (Mimeograph Letter to Collectors No. 1675, November 3, 1917.)

## CHAPTER IV

## RATES, COMPUTATION OF TAX AND PAYMENT

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**SURTAX ON THE SALE OF MINERAL DEPOSITS.**—It should be noted that Section 211 (b) reads as follows:

**LAW.** Section 211. . . . (b) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by this section attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest.

**REGULATION.** Where the taxpayer by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of mines, oil or gas wells, which prior to his efforts had a merely nominal value, the portion of the surtax attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 20 per cent of the selling price. Exploration work alone without discovery is not sufficient to bring a case within this provision. Shares of stock in a corporation owning mines, oil or gas wells do not constitute an interest in such property. To determine the application of this provision to a particular case, the taxpayer should first compute the surtax in the ordinary way upon his net income, including his net income from any such sale. The proportion of the surtax indicated by the ratio which the taxpayer's profit from the sale of the property bears to the sum of his total income plus the general deductions not chargeable against any particular item of gross income is the portion of the surtax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the surtax shall be reduced to that amount. (Reg. No. 45, Article 13.)

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**SPECIAL RATES ON TRANSPORTATION COMPANIES UNDER GOVERNMENT CONTROL.**—

**REGULATION.** The act to provide for the operation of transportation systems while under federal control, for the just compensation of their owners, and for other purposes, of March 21, 1918, authorizes the President to agree with carriers for their just compensation and provides:

Every such agreement shall provide that any federal taxes under the act of October third, nineteen hundred and seventeen, or acts in addition thereto or in amendment thereof, commonly called war taxes, assessed for the period of federal control beginning January first, nineteen hundred and eighteen, or any part of such period, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation; that other taxes assessed under federal or any other governmental authority for the period of federal control or any part thereof, either on the property used under such federal control or on the right to operate as a carrier, or on the revenues or any part thereof derived from operation (not including, however, assessments for public improvements or taxes assessed on property under construction, and chargeable under the classification of the Interstate Commerce Commission to investment in road and equipment), shall be paid out of revenues derived from railway operations while under federal control; that all taxes assessed under federal or any other governmental authority for the period prior to January first, nineteen hundred and eighteen, whenever levied or payable, shall be paid by the carrier out of its own funds, or shall be charged against or deducted from the just compensation.

Accordingly, in the case of transportation corporations while under federal control five-sixths of the tax for the calendar year 1918 and four-fifths of the tax for each calendar year thereafter shall be paid by the carrier out of its own funds or deducted from its just compensation, and the remainder of the tax shall be paid out of revenues derived from railway operations while under federal control. (Reg. No. 45, Article 504.)

ILLUSTRATIONS OF RETURNS.—On the following pages are shown illustrations of returns under varying conditions.

Fill out check first

DELIVER OR SEND  
THIS RETURN  
WITH PAYMENT  
TO COLLECTOR OF  
INTERNAL  
REVENUE ON OR  
BEFORE  
MARCH 15, 1919

DETACH AND KEEP  
WORK SHEET  
AND INSTRUCTION  
SHEET

## Page 1 of Return

Form 1040A.—UNITED STATES INTERNAL REVENUE SERVICE

## INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES OF NOT MORE THAN \$5,000

For Calendar Year 1918

PRINT NAME AND ADDRESS PLAINLY BELOW

Do not write in this space

FIRST PAYMENT

\$

(Cashier's Stamp.)

CASH CHECK M. O.

Examined by

1. Did you make a return for 1917? .....
2. If so, what address did you give on that return? .....
3. To what collector's office was it sent? .....
4. Give district or city and State.
5. Were you in 1918 married and living with wife (or husband)? .....
6. If not, were you the head of a family as defined in instructions under "Personal Exemption"? .....
7. How many dependent persons under 18 (or mentally or physically defective) received their chief support from you during 1918? .....
8. If you claim any additional exemption on account of dependent persons other than your children, what was their relationship to you? .....
9. Write "R" if this return shows income received, or "A" if it shows income accrued.
10. Did your wife (or husband) or minor child make a separate return? .....
- (If so, give name and address thereon.)
11. Did you or your wife (or husband) or dependent minor children receive any interest on U. S. Liberty Bonds, or any salary not reported elsewhere in this return or in a separate return? .....
- (If so, give sources and amounts.)
12. Enter name and address of each organization to which you made contributions claimed as deductions, and amount paid to each.
13. Enter in this table details concerning repairs, wear and tear, and property losses, claimed as deductions in Schedules A, E, and I on page 2 of return (see instructions):

1. Refer to "A," "B," or "C."	2. Kind of property. (If buildings, state also material of which constructed.)	3. Year acquired.	4. Cost of property (or market value March 1, 1913).	5. Repairs not offset by claims for wear and tear or losses.	6. Rate.	7. Amount previous years.	8. Amount this year.	9. Cause of loss.	10. Amount of loss.
			\$	\$		\$	\$		\$
			\$	\$		\$	\$		\$
			\$	\$		\$	\$		\$

## CALCULATION OF TAX

Do not write here.	Do not write here.
M. Net income shown on page 2, Item J	P. Tax due (6% on amount of Item O)
N. Less personal exemption (see instruction VI)	Q. Less normal tax of 2% on Item F
O. Balance (income taxable at 6%)	R. Balance of tax due
NOTE:—If the amount on line O exceeds \$4,000, the excess is taxable at 15%, and your return should be made on Form 1040.	S. Amount of tax paid on submission of return.

## AFFIDAVIT

I swear (or affirm) that this return, to the best of my knowledge and belief, is a true and complete statement of all taxable gains, profits, and income received by or accrued to me (or the person for whom this return is made) during the year 1918, and that all deductions entered or claimed herein are allowable under the law.

(If return is made by agent, the reason therefor must be stated on this line.)

Sworn to and subscribed before me this ..... day of ....., 1919.

(Signature of individual or agent.)

(Signature of officer administering oath.)

(Title.)

(Address of individual or agent.)

1024

DETACH RETURN HERE AND SEND IT TO COLLECTOR OF INTERNAL REVENUE AT

## Page 1 of Instructions

# INSTRUCTIONS FOR FILLING INDIVIDUAL INCOME TAX RETURN FOR NET INCOMES OF NOT MORE THAN \$5,000

### I. HOW TO DECIDE WHETHER TO MAKE A RETURN.

1. Calculate your net income by filling in page 3 of the work sheet according to page 3 of the instructions.
2. Add the net income of your wife (or husband) and dependent minor children, if any, except as provided in paragraph 4.
3. The total family income, calculated in accordance with paragraphs 1 and 2, must be reported, either in your return or in a separate return by wife (or husband), if it equals or exceeds—
  - (a) \$2,000 if you are married and live with your wife (or husband).
  - (b) \$1,000 if you are not married and do not live with your wife (or husband).
4. Income of a minor or incompetent, if derived from a separate estate under control of a guardian, trustee, or other fiduciary, must be reported by his guardian or other legal representative.

### II. ACCRUED OR RECEIVED INCOME.

1. If you keep books showing income accrued and expenses incurred during the year, make your return from your books, but do not fail to include all your income even if it is not entered in your books.
2. If you do not keep books showing income accrued and expenses incurred, report income received and expenses paid.
3. If you report income accrued, you must include all income that accrued in 1917 but was not received until 1918, unless it was reported in last year's return.
4. If you report income received, you must include all income constructively received, as bank interest credited to your account.

### III. RECEIPTS EXEMPT FROM TAX.

The following classes of receipts are exempt from income tax, and need not be reported on page 3 of the return:

1. Pay, not exceeding \$2,500, for active service in the military and naval forces of the United States.
2. Gifts (not made as a consideration for services rendered) and money and property acquired under a will or by inheritance (but the income derived from money or property received by gift, will, or inheritance is taxable and must be reported).
3. Interest on bonds and other obligations of the United States issued before September 1, 1917, and on such bonds and other obligations issued since that date, provided your holdings do not exceed the exemptions allowed by law.
4. Interest on bonds and other obligations of United States possessions (Philippines, Porto Rico, etc.).
5. Interest on bonds and other obligations of States, territories, political subdivisions thereof (such as cities, counties, and townships), and the District of Columbia.
6. Interest on Federal Farm Loan bonds.
7. Proceeds of life insurance policies paid on the death of the insured.
8. Amounts received by the insured under life insurance, endowment, and annuity contracts, provided such payments do not exceed the premiums paid in. The amount by which the total payments that have been received exceed the total premiums paid in is income and must be reported in Schedule G.
9. Amounts received from accident and health insurance and under workman's compensation acts plus the amount of any damages received by suit or agreement on account of injuries or sickness.

### IV. FARMER'S INCOME SCHEDULE.

If you are a farmer, get from the collector and fill out a "Schedule of Farm Income and Expenses." Transfer the net farm income to line 31 of Schedule A of the return. Report income from salaries, rents, interest, sales of property, etc., in Schedules B to G of the return. Send your Schedule of Farm Income and Expenses with the return to the collector.

### V. PERIOD TO BE COVERED BY RETURN.

1. You must report your net income for the calendar year 1918, except under the following conditions stated in paragraph 2.
2. If you are engaged in business and keep books of account which are regularly closed each year at the end of some month other than December to determine your annual profit or loss, you may, after obtaining the collector's approval, make a return covering the period from January 1, 1918, to the date on which you closed your books, and thereafter for each period of 13 months.
3. If you make a return for a part of the calendar year 1918, your personal exemption shall be as many twelfths of the amount that would be allowed for a full year as there are months in the period covered by the return.
4. The dates on which the period covered by the return begins and ends, if other than the calendar year 1918, must be plainly stated at the head of the return; answers to questions 4, 6, and 7 must be given for that period; and the affidavit must be changed accordingly.

### VI. PERSONAL AND FAMILY EXEMPTION.

1. If you were married and lived with your wife (or husband) or were head of a family in 1918, you may subtract from your net income, before deducting your tax, a family exemption of \$2,000 plus \$200 for each person under 18 (or mentally or physically defective) who received his chief support from you. If husband and wife make separate returns, this exemption may be claimed by either (but not by both) or may be divided between them.
2. If you were not married or did not live with wife (or husband) and were not head of a family in 1918, you are entitled to a personal exemption of \$1,000 plus \$200 for each dependent person under 18 (or mentally or physically defective) who received his chief support from you.
3. If you were entitled to any of the foregoing exemptions during a part of the year only, you may claim as many twelfths of the exemptions stated as there were months in such part of the year. Any part of a month may be counted as a month.
4. The personal or family exemptions must be reported on line No. 1, page 1, of the return, and must be supported by answers to questions 5, 6, 7, and 8.
5. A "head of family" is a person who is the chief support of one or more persons living in his household, who are closely related to him (or her) by blood, marriage, or adoption.

### VII. WHEN TO USE FORM 1040 INSTEAD OF THIS FORM.

- You must make your return on Form 1040—
- (a) If your net income is over \$5,000.
  - (b) If the net income reported in this return exceeds \$4,000 and the entire family exemption has been claimed in a separate return made by wife (or husband).
  - (c) If this form does not provide for all the facts you have to report (as, for example, if you receive income from a partnership or personal service corporation with a fiscal year falling partly in 1917 and partly in 1918).

### VIII. AFFIDAVIT.

1. The affidavit must be executed by the person whose income is reported unless he is a minor or incompetent or unless he is ill, absent from the country, or otherwise incapacitated, in which case the legal representative or agent may execute the affidavit.
2. The oath will be administered without charge by any collector or deputy collector of internal revenue, or (if you are in the military or naval service of the United States) by any military or naval officer who is authorized to administer oaths for the purposes of military or naval justice and administration. If on internal revenue officer is not available, the return should be sworn to before a notary public, justice of the peace, or other person authorized to administer oaths.

### IX. WHEN AND WHERE THE RETURN SHOULD BE SENT.

Send your return to the collector of internal revenue for the district in which you live or have your place of business so that it will reach him on or before March 15, 1919. If the address of the collector is not printed on the return and you do not know it, ask at the post office or bank.

### X. WHEN AND TO WHOM THE TAX MUST BE PAID.

1. The tax should be paid, if possible, by sending or bringing with the return a check or money order drawn to the order of "Collector of Internal Revenue at [insert name of city and State]."
2. Do not send cash through the mail, or pay it in person except at the office of the collector or a regularly established internal revenue stamp office.
3. At least one-fourth of the tax is due at the same time that the return is due.
4. An additional amount sufficient to bring the total payments up to one-half of the tax is due on or before June 15, 1919.
5. An additional amount sufficient to bring the total payments up to three-fourths of the tax is due on or before September 15, 1919.
6. The entire remainder of the tax is due on or before December 15, 1919.
7. If any payment is not made when due, a penalty of 5 per cent. of the amount due but unpaid will be incurred. The entire unpaid balance of the tax will also become due 10 days after demand therefor by the collector.
8. If you pay in cash, do not fail to get a receipt at the time of payment.
9. If you pay by check or money order, your canceled check or your money order receipt will serve as a receipt.

### XI. PENALTIES.

#### For Making False or Fraudulent Return.

Not exceeding \$10,000 or not exceeding one year's imprisonment, or both, in the discretion of the court, and, in addition, 50 per cent of the tax evaded.

#### For Failing to Make Return on Time.

Not more than \$1,000, and, in addition, 25 per cent. of the amount of tax due.

#### For Failing to Pay Tax When Due.

Five per cent. of the amount unpaid, plus 1 per cent interest for each full month during which it remains unpaid.

Page 2 of Instructions.

## INSTRUCTIONS FOR FILLING IN TAXABLE INCOME

## A. INCOME FROM BUSINESS OR PROFESSION.

Report here income from:

(a) Sale of merchandise, or of products of manufacturing, construction, mining, and agriculture. (For farm income see Instruction IV on the back of this sheet.)

(b) Business service, such as transportation, storage, laundering, hotel and restaurant service, heavy and garage service, etc., if you own the business. If you are engaged in the business as an employee, report your salary or wages in Schedule B.

(c) A profession, such as medicine, law, or dentistry, if you practice it on your own account. If you are employed on a salary, report your salary in Schedule B.

In general, report in Schedule A any income in the earning of which you incur expenses for labor, rent, etc. Do not report here partnership profits or profits of personal service corporations, which should be entered under C, or dividends from other corporations, which should be entered under K.

If you are a farmer (or a farm owner renting your farm to another person on shares), enter on line 21 your net income from farming, as shown by your "Schedule of Farm Income and Expenses."

Kind of business.—Enter "grocery," "retail clothing," "drug store," "laundry," "doctor," "lawyer," etc.

If you keep books showing income accrued, report such income instead of cash received, and report expenses incurred instead of expenses paid.

Income received from sale of lands, buildings, equipment, stocks, bonds, and other property not dealt in as a business should be reported under D.

Total sales and income from business or profession.—Report the total amount derived from sales, less any discounts or allowances from the sale price.

Other business deductions.—Do not include cost of business equipment or furniture, expenditures for permanent improvements to property, or living and family expenses. Do not deduct interest on your own investment in your business or salary or wages for your own services. The services of your family, unless these items are included as income in Schedule B or G.

Rent.—Report here rent for business property (not including rent for dwelling you occupy).

Interest.—Report here interest on business indebtedness, including indebtedness incurred to purchase or carry business property.

Taxes.—Report here only taxes on business property or for carrying on business. Do not include taxes assessed against local benefits of a kind tending to increase the value of the property assessed, as for paving, sewers, etc., nor Federal income taxes.

Repairs, wear and tear, and property losses.—Report here (a) ordinary repairs required to keep property in usable condition (b) depreciation during the year on business property, only to the extent not offset by repairs or losses claimed in this or previous returns, and (c) losses of business property by fire, storm, theft, etc., not compensated for by insurance or otherwise, and for which no claim for insurance is pending. Explain these deductions in table, page 1 of the return, Item 13.

Do not claim depreciation or losses on articles that have been taken into your inventory at a figure reflecting the reduction in value.

Bad debts.—Report here only debts arising from sales that have been reported as income, which have been definitely proved to be worthless and have been charged off within the year.

Other expenses.—Do not include your personal exemption here. This is to be reported as item IV.

Net loss.—If the net cost of goods sold plus other business expenses is in excess of the total amount of sales and income from business or professional services, report the difference as a loss by using red ink or a minus sign.

## B. INCOME FROM SALARIES, WAGES, COMMISSIONS, BONUSES, DIRECTOR'S FEES, AND PENSIONS.

If salary, wage, or other compensation received by you, your wife (or husband), or dependent child was at the rate of \$1,000 or more per annum, report it on a separate line, together with the occupation or position and employer's name and address. All other income from salaries, wages, com-

missions, etc., at a rate less than \$1,000 per annum should be reported on a single line.

Do not report pay, not exceeding \$3,500, for active service in the Army or Navy (see Instructions III, paragraph 1, on the other side of this sheet).

Explain deductions in any convenient blank space on the return. Do not enter your personal exemption here.

## C. INCOME FROM PARTNERSHIPS, PERSONAL SERVICE CORPORATIONS, AND ESTATES AND TRUSTS.

Report your share (whether received or not) in the profits of the partnership or personal service corporation or in the income of estate or trust (if placed to your credit), not including the part of such share that consisted of dividends on stock of ordinary corporations (to be included in Item K), interest on obligations of the United States (see question 11), or (in the case

of estates and trusts) interest on corporation bonds containing a tax-free covenant, upon which a tax of 3 per cent was paid (or will be paid) by the debtor corporation (to be included in Item F).

Report in Schedule B salary received from partnership or personal service corporation.

## D. PROFIT FROM SALE OF LAND, BUILDINGS, STOCKS, BONDS, AND OTHER PROPERTY.

Use this schedule for all sales of real estate, and for sales of other property that you do not deal in as a business.

Kind of property.—Describe the property as definitely as you can in a word or two, as "farm," "house," "lot," "stock," "bonds."

Sale price.—State the actual consideration or price, or, in case of an exchange, the fair market value of the property received.

Cost.—Enter the original cost of the property or, if it was acquired before

March 1, 1913, its fair market value on that date. Expenses incidental to the purchase may be included in the cost if never claimed in income tax return as deductions from income. Enter in column 7 the amount of wear and tear (depreciation) or depletion sustained since March 1, 1913 (or since date of acquisition if subsequent to March 1, 1913). (This is a deduction from cost, though treated for convenience as an addition to the sale price.)

Losses.—If the total of columns 5 and 6 is in excess of the total of columns 4 and 7, report the difference as a loss by using red ink or a minus sign.

## E. INCOME FROM RENTS AND ROYALTIES.

Kind of property.—Describe briefly, as in D.

Cash or equivalent received.—If a tenant rented your property on a cash rental basis, but paid the rent in crops or other property, report the amount of the rent as income for the year in which you received such crops or other property (unless your return shows income accrued).

Wear, tear, repairs, and property losses.—See Instructions for Schedule A above. Explain in Item 13, page 1, of the return.

Other expenses and losses.—Report taxes on rented or leased property and interest on indebtedness incurred or continued to purchase or carry it. Do not include taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

## F. INTEREST ON CORPORATION BONDS CONTAINING TAX-FREE COVENANT, ON WHICH TAX OF 2% WAS PAID BY DEBTOR CORPORATION.

This item should include all interest received directly or through fiduciaries on bonds of corporations organized or doing business in the United States, containing a clause by which the debtor corporation agrees to pay the interest without any deduction for taxes, provided exemption from withholding was

not claimed by the owner of the bonds. If exemption was claimed, the interest received must be reported in G. (The amount of tax paid by the debtor corporation is treated as a credit against the tax due. See Item Q, page 1 of the return.)

## G. OTHER INCOME (NOT INCLUDING DIVIDENDS).

Report in this schedule interest received on bank deposits, notes, mortgages, etc., and all other income not reported in Schedules A to F, except—

(a) Dividends received from corporations organized or doing business in the United States (see Item K).

(b) Receipts exempt from tax, as stated in Instruction III on the other side of this sheet.

State separately income from each source.

Deductions.—Interest paid on loans secured by bonds may be reported here as an offset to the interest received. Explain deductions in any convenient blank space on the return.

## I. GENERAL DEDUCTIONS.

Interest.—Report here interest paid on personal indebtedness as distinguished from business indebtedness (which should be reported under A, E, or G above). Do not include interest on indebtedness incurred for the purchase of bonds and other obligations, the interest on which is exempt from tax (see Instruction III, page 1).

Taxes.—Report here taxes paid on your dwelling and household property, not including those assessed against local benefits of a kind tending to increase the value of the property assessed. Do not include Federal income taxes, nor estate or inheritance taxes.

Losses.—Report here losses of property not connected with your trade, business, or profession, sustained during the year from fire, storm, ship-

wreck, or other casualty, or from theft, which were not compensated for by insurance or otherwise, and for which no claim for insurance is pending. Explain such losses in Item 13 on page 1 of the return.

Contributions.—Report here only contributions made within the year to corporations organized and operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals, or to the special fund for vocational rehabilitation. The total amount of contributions to be entered here must not exceed 16 per cent of the net income computed without the benefit of this deduction.

Other deductions.—Bad debts arising out of personal loans may be reported here.

## RETURN OF TAXABLE INCOME

(Including income of wife (or husband) and dependent minor children, unless reported in separate returns (see instruction 1))

**A. INCOME FROM BUSINESS OR PROFESSION.**

1. Kind of business.....	2. Business address.....		
3. Total sales and income from business or professional services.....		\$	
<b>COST OF GOODS SOLD:</b>			
4. Labor.....	\$		
5. Material and supplies.....	\$		
6. Merchandise bought for sale.....	\$		
7. Other costs.....	\$		
8. Plus inventories at beginning of year.....	\$		
9. TOTAL.....	\$		
10. Less inventories at end of year.....	\$		
11. <b>Net Cost of Goods Sold</b> .....	\$		
<b>OTHER BUSINESS DEDUCTIONS:</b>			
12. Salaries and wages not reported as "Labor" under "Cost of Goods Sold".....	\$		
13. Rent.....	\$		
14. Interest on business indebtedness.....	\$		
15. Taxes on business and business property.....	\$		
16. Repairs, wear and tear, and property losses.....	\$		
17. Bad debts arising from sales.....	\$		
18. Other expenses.....	\$		
19. <b>TOTAL OTHER BUSINESS DEDUCTIONS</b> .....	\$		
20. <b>Net Cost of Goods Sold Plus Total Other Business Deductions</b> .....		\$	
21. <b>Net Income from Business or Profession</b> .....		\$	

**B. INCOME FROM SALARIES, WAGES, COMMISSIONS, BONUSES, DIRECTOR'S FEES, AND PENSIONS.**

1. By whom received.....	2. Occupation.....	3. Name and address of employer.....	4. Gross income.....	5. Deductions, if any.....
			\$	\$
			\$	\$
			\$	\$
			\$	\$
Net Income from Salaries, etc. (total of column 4 minus total of column 5).....			\$	\$

**C. INCOME FROM PARTNERSHIPS, PERSONAL SERVICE CORPORATIONS, AND ESTATES AND TRUSTS (not including amounts reported under F and K)  
(State name and address of partnership, etc.).....**

\$

**D. PROFIT FROM SALE OF LAND, BUILDINGS, STOCKS, BONDS, AND OTHER PROPERTY.**

1. Kind of property.....	2. Year acquired.....	3. Name of purchaser or broker.....	4. Sale price.....	5. Original cost or market value March 1, 1913.....	6. Cost of subsequent improvements, if any.....	7. Depreciation subsequently sustained.....
			\$	\$	\$	\$
			\$	\$	\$	\$
			\$	\$	\$	\$
Net Profit from Sale (total of col. 4 and 7 minus total of col. 5 and 6).....			\$	\$	\$	\$

**E. INCOME FROM RENTS AND ROYALTIES.**

1. Kind of property.....	2. Name and address of tenant or lessee.....	3. Cash or equivalent received.....	4. Wear, tear, repairs, and property losses.....	5. Other expenses and losses.....
		\$	\$	\$
		\$	\$	\$
		\$	\$	\$
Net Income from Rents and Royalties (total of col. 3 minus total of col. 4 and 5).....		\$	\$	\$

**F. INTEREST ON CORPORATION BONDS CONTAINING TAX-FREE COVENANT, ON WHICH A TAX OF 2% WAS PAID BY DEBTOR CORPORATION (including such interest received through fiduciaries).....**

\$

**G. OTHER INCOME (not including dividends) (State each source separately).....**

1. Cash received.....	2. Deductions, if any.....
\$	\$
\$	\$
\$	\$
Net Total (total of column 1 minus total of column 2).....	
\$	\$

**H. TOTAL NET INCOME FROM ABOVE SOURCES.....**

\$

**I. GENERAL DEDUCTIONS NOT INCLUDED ABOVE.**

1. Interest paid on indebtedness.....	2. Losses by fire, storm, or casualty not claimed above.....	3. Other deductions, if any.....
\$	\$	\$
\$	\$	\$
4. Taxes paid.....	5. Contributions.....	TOTAL.....
\$	\$	\$

J. Total net income on which normal tax is to be calculated (H minus I) (Enter as Item M, page 1)..... \$

K. Dividends on stock of corporations organized or doing business in the United States (including dividends received through partnerships, personal service corporations, and fiduciaries)..... \$

L. Total net income (if this amount is over \$5,000, make your return on Form 1040)..... \$



# SUGGESTED DRAFT STATEMENT TO BE PREPARED BY INDIVIDUAL TAXPAYER BEFORE FILLING IN FORM 1040 A

MARRIED MAN, 1 CHILD (UNDER 18) NO SURVIVAN. CALENDAR YEAR—CASH BASIS.

## DETAILS OF INCOME:

PAGE	ITEM				
57	B-Col. 4	Gift from father .....	\$200.00	Do not report	
200	B-Col. 4	Salary .....	\$2,500.00	300.00	\$2,200.00
401	B-Col. 5	Deduction for business expenses.....			
217	D	Profit on sales of stocks.....	\$200.00		
499	D	Losses on sales of stocks.....	800.00		
		Deductible .....	600.00		
					\$1,600.00
318	E-Col. 3	Rents .....			
442	E-Col. 5	Deduction for real estate expenses.....	\$150.00		
535	E-Col. 4	Deduction for depreciation of buildings.....	350.00		
452	E-Col. 5	Deduction for interest on mortgage.....	500.00		
404	E-Col. 5	Deduction for real and personal property taxes.....	100.00		500.00
295	II	Interest on First Liberty Bonds, 3½%.....	\$35.00	Do not report	
296	II	Interest on Second Liberty Bonds, 4% (principal \$15,000).....	\$600.00 <sup>1</sup>	Do not report	
296	II	Interest on Third Liberty Bonds, 4½% (principal \$2,500).....	\$37.25 <sup>2</sup>	Do not report	
315	F	Interest on corporate bonds containing "tax-free" provision.....			400.00
293	G-Col. 1	Interest on corporate bonds containing no "tax-free" provision.....			100.00
327	K	Cash dividends received.....			600.00
370	C	Income as partner, net distributive share.....			2,000.00
		Total Income .....			\$5,200.00
448	I-1	Deduction for interest paid on money borrowed to purchase or carry Second, Third and Fourth Liberty Bonds.....		\$200.00	
448		Interest paid on money borrowed to carry First Liberty Bonds.....	\$54.00	Do not report	

PAGE ITEM

464	I-2	Deduction for State Income Tax.....	40.00	
519	I-5	Deduction for Bad Debt (loan to friend in 1917, considered good January 1, 1918).....	100.00	340.00
		Net Income before deducting contributions.....		<u>\$4,860.00</u>
		Total amount contributed to charities during 1918 (give details).....	<u>\$1,000.00</u>	
424		Amount allowable is 15% of net taxable income, viz., income as above.....	<u>\$4,860.00</u>	
	I-4	15% thereof .....		729.00
		Net Income .....		<u>\$4,131.00</u>
325	K	Credit dividends .....		600.00
	J & M	Net Income subject to Normal Tax.....		<u>\$3,531.00</u>
46	N	Exemption \$2,000 plus \$200.....		2,200.00
	O	Balance taxable .....		<u>\$1,331.00</u>
112	P	Normal Tax at 6%.....		<u>\$79.86</u>
315	Q	Credit tax paid at source on "tax-free" bonds.....		8.00
	R	Net Tax due .....		<u>\$71.06</u>

Note: Inasmuch as net income did not exceed \$5,000 no surtax is payable.

<sup>1</sup>Interest is exempt owing to \$10,000 Fourth Liberty Bonds being originally subscribed for and still held.  
<sup>2</sup>Interest to extent of \$5,000 of principal any issue, exempt.

**DETACH AND KEEP  
WORK SHEET  
AND  
INSTRUCTION SHEET**

Form 1040—UNITED STATES INTERNAL REVENUE SERVICE

### FOR NET INCOMES OF MORE THAN \$5,000

**FOR CALENDAR YEAR 1918**

If the return is made for a part of the calendar year 1918, the date on which the period covered by the return ends must be plainly stated at the head of the return.

**PRINT NAME AND ADDRESS PLAINLY BELOW**

70

(Street and number or rural route)

(Post office and State)

**DO NOT WRITE IN THESE SPACES**

Examined by \_\_\_\_\_

Approved by

**FIRST PAYMENT**

3

(Cashier's Stamp)

**CASE**

**CW200**

NO

**CERT.**

--	--

1. Did you make a return for 1917..... 2. If so, what address did you give on that return?
3. To what Collector's office was it sent? (Give district or city and State.) 4. Give number, if any, assigned to you for 1917, if it does not appear in address at head of return.
5. Were you in 1918 married and had any child or children? 7. How many dependent persons under 18 (or mentally or physically defective) were supported by you in 1917?
6. If not, were you head of a family as defined in instructions under "Personal Exemption"? 8. Write "B" if this return shows income received or "A" if it shows income received.
9. If you claim any additional exemption on account of dependent persons other than your children, what was their relationship to you?
10. Did your wife (or husband) or life tenant and address entered at head of that return..... (If so, give name and address of minor child making a separate return.)
11. Enter below all non-exempt income received by (or accrued to) you during the year:

CLASS OF SECURITIES.	PRINCIPAL.	INTEREST.	CLASS OF SECURITIES.	PRINCIPAL.	INTEREST.	SALARY, ETC. (GIVE SOURCE).	AMOUNT.
Bonds of First Liberty Loan unconverted .....	\$	\$	Indemnities of States and Territories, political subdivisions thereof, and the District of Columbia.	\$	\$		\$
Other obligations of the U. S. issued before Sept. 1, 1917, and not converted .....	\$	\$	Federal Farm Loan Bonds.				

12. State amount of stock dividends received by (or accrued to) you directly during the year, declared from earnings of domestic or resident corporations accumulated since February 28, 1913, and prior to January 1, 1918:
- (a) Accumulated in 1917, \$ ..... (b) Accumulated in 1916, \$ ..... (c) Accumulated since February 28, 1913, and prior to January 1, 1918, \$ .....

13. Enter in table below interest on Liberty Bonds and other obligations of the United States issued since September 1, 1917, received by (or accrued to) you during the year, and maximum amount of such obligations (par value) held at any one time from which such interest was derived (see instructions, page 2, under K(b)).

1. CLAIM OF OBLIGATION.	INDIVIDUAL HOLDINGS.		SHARES OF HOLDINGS OF PARTNERSHIPS, FINANCIAL SERVICE CORPORATIONS, AND TRUSTS AND OTHERS.		8. TOTAL OF COLUMNS 2 AND 8.	7. MAXIMUM EXEMPTION.
	2. AMOUNT OF INTEREST.	3. MAXIMUM AMOUNT OF OBLIGATION.	4. AMOUNT OF INTEREST.	5. MAXIMUM AMOUNT OF OBLIGATION.		
(a) First Liberty Loan converted into Second Loan and Second Liberty Loan interest (interest received since January 1, 1938).						\$45,000 (See Note.)
(b) First and Second Liberty Loans converted into Third Loan and Third Liberty Loan.						In addition an exemption of \$5,000 may be claimed and to any one of these classes or may be divided among them
(c) First Liberty Loan converted into Fourth Loan.						30,000
(d) Fourth Liberty Loan.						30,000
(e) Other obligations issued since September 1, 1917.						0
(f) TOTALS.	\$	\$	\$	\$		

**NOTE.**—This exemption (maximum \$45,000) is limited to one and one-half times the amount of bonds of the Fourth Liberty Loan originally subscribed for and still held. State here amount of bonds of the Fourth Liberty Loan originally subscribed for and still held.

- 14. Enter in the table below income from partnerships, personal service corporations, and estates and trusts:**

1. NAME OF PAYOR/OWNER, PERSONAL SERVICE CORPORATION, ESTATE, OR TRUST. (If estate or trust, give also name of decedent.)	2. PERIOD (ENTER 1915 OR DATE OF WILLS FINAL YEAR ENDED).	3. CASH DIVIDENDS.	4. STOCK DIVIDENDS.	5. INTEREST ON TAX-FREE BONDS (FROM ESTATE AND TRUSTS ONLY).	6. INTEREST ON LABRET BONDS, INC., ISSUED BOND SERV. 1, 1917.	7. OTHER INCOME.	8. TOTAL.
		\$	\$	\$	\$	\$	\$
(a) Totals taxable at 1915 rates (see instructions, page 2, under C)		\$	\$	\$	See instructions, page 2, under E (3).	Enter on G, page 4.	X X X X Enter on 17, below.
(b) Totals taxable at 1917 rates (see instructions, page 2, under D)		\$	\$	X X X X			\$
(c) Amount of stock dividends (column 4) taxable at 1915 rates (enter as 20), \$							
(d) Amount of stock dividends taxable at 1915-15 rates (enter as 25), \$							

- (c) Amount of stock dividends (column 4) taxable at 1916 rates (enter as 20), \$ \_\_\_\_\_ (d) Amount of stock dividends taxable at 1915-16 rates (enter as 25), \$ \_\_\_\_\_

Total Net Income Subject to Surtax.		Total Net Income Subject to Normal Tax.		Calculation of Tax.	
15. Item I, page 7.		AT 1918 RATES.		33. Normal tax of 6% on amount of Item 29.	
16. Item 12 (a)		25. Net income shown on page 2, Item 7.		34. Normal tax of 12% on amount of Item 29.	
17. Item 14 (b), column 8.		26. Less personal exemption		35. Normal tax of 4% on amount of Item 32.	
18. TOTAL (Items 15, 16, and 17)		27. BALANCE		36. Surtax at 1918 rates (see surtax table on page 1 of instructions)	
19. Item 12 (b)		28. Amount subject to tax at 6% (not over \$4,000).		37. Surtax at prior-year rates (see surtax table on page 1 of instructions)	
20. Item 14 (c)		29. BALANCE SUBJECT TO TAX AT 12%.		38. TOTAL TAX	
21. TOTAL (Items 18, 19, and 20)		AT 1917 RATES.		39. Tax paid at 7% (7% of amount of Item 7, page 3).	
22. Item 12 (c)		30. Amount of Item 14 (b), column 7.		40. Less, the profit and/or common losses paid in 1917 to foreign countries and possessions of the U.S.	
23. Item 14 (d)		31. BALANCE of personal exemption not used above (Item 26 minus Item 28)		41. BALANCE OF TAX DUE (Item 38 minus Items 39 and 40)	
24. TOTAL NET INCOME (Items 21, 22, and 23)		32. BALANCE SUBJECT TO TAX AT 4%.		42. Amount of tax paid on submission of RETURN	

I swear (or affirm) that this return including the accompanying schedules and statements (if any), has been examined by me and, to the best of my knowledge and belief, is a true and complete return in good faith, pursuant to the income tax law and regulations, of all taxable gains, profits, and income received by or accrued to me (or the person for whom this return is made) during the year 1918, and that all deductions entered or claimed herein are allowable by law.

(If return is made by agent, the reason therefor must be stated on this line)

Sworn to and subscribed before me this \_\_\_\_\_ day of \_\_\_\_\_, 1919.

(Signature of individual or agent)

(Signature of officer administering oath)

(Title)

(Address of individual or parent)

2-000000

# Page 1 of Instructions

## INSTRUCTIONS FOR FILLING INDIVIDUAL INCOME TAX RETURN FOR NET INCOMES OF MORE THAN \$5,000

### I. HOW TO DECIDE WHETHER TO MAKE A RETURN.

1. Calculate your net income by filling in page 2 of the work sheet according to page 2 of the instructions.
2. Add the net income of your wife (or husband) and dependent minor children, if any, except as provided in paragraph 5.
3. The total family income, calculated in accordance with paragraphs 1 and 2, must be reported, either in your return or in a separate return by wife (or husband), if it is equal to or exceeds:
  - (a) \$2,000 if you were married and lived with your wife (or husband).
  - (b) \$1,000 if you were not married or did not live with your wife (or husband).

4. In any case, you must make a return if your net income equaled or exceeded the amount of your personal exemption, not including any additional exemption allowed you as head of family or on account of dependents.

5. Income of a minor or incompetent, if derived from a separate estate under control (a guardian, trustee, or other fiduciary, must be reported by his guardian or other legal representative.
6. If your wife (or husband) had any separate income, she (or he) should make a separate return.

### II. ACCRUED OR RECEIVED INCOME.

1. If you keep books showing income accrued and expenses incurred during the year, make your return from your books, but do not fail to include all your income even if it is not earned in your books.
2. If you do not keep books showing income accrued and expenses incurred, report income received and expenses paid.
3. If you report income accrued, you must include all income that accrued in 1917 but not received until 1918, unless it was reported in last year's return.
4. If you report income received, you must include all income constructively received, as bank interest credited to your account.

### III. RECEIPTS EXEMPT FROM TAX.

The following classes of receipts are exempt from income tax, and need not be reported on page 2 of the return: (1) Receipts of the character described in paragraph 1, 2, 3, 4, 5, and 6 should be reported in table 11, page 1 of the return.

1. Pay not exceeding \$5,000, for active services in the military and naval forces of the United States.
2. Gifts (not made as a consideration for service rendered) and money and property acquired under a will or by inheritance (but the income derived from money or property received by gift, will, or inheritance is taxable and must be reported).
3. Interest on bonds and other obligations of the United States issued before September 1, 1917, and on such bonds and other obligations issued since that date, provided your holdings do not exceed the exemption allowed by law. See table 13, page 1 of return, and instructions, page 2, under K(b).
4. Interest on bonds and other obligations of United States possessions (Philippines, Porto Rico, etc.).
5. Interest on bonds and other obligations of States, territories, political subdivisions thereof (such as cities, counties, and townships), and the District of Columbia.
6. Interest on Federal Farm Loan bonds.
7. Proceeds of life insurance policies paid on the death of the insured.
8. Amounts received by the insured under life insurance, endowment, and annuity contracts, provided such payments do not exceed the premiums paid. The amount by which the total payments that have been received exceed the total premiums paid in is income and must be reported in Schedule G.
9. Amounts received from accident and health insurance and under workman's compensation acts plus the amount of any damages received by suit or agreement on account of injuries or sickness.

### IV. FARMER'S INCOME SCHEDULE.

If you are a farmer or a farm owner renting your farm out on shares, get from the collector all out a "Schedule of Farm Income and Expenses." Transfer the net farm income to line 21 of Schedule A of the return. Report income from salaries, rents, interest, and other property, etc., in Schedules B to G of the return. Send your Schedule of Farm Income and Expenses with the return to the collector.

### V. PERIOD TO BE COVERED BY RETURN.

1. You must report your net income for the calendar year 1918, except under the conditions stated in paragraph 2.
2. If you are engaged in business and keep books of account which are regularly closed each year at the end of some month other than December to determine your annual profit or loss, you may, after obtaining the Commissioner's permission, make a return covering the period from January 1, 1918, to the date on which you closed your books, and thereafter for each period of 12 months.

3. If you make a return for a part of the calendar year 1918, your personal exemption shall be as many twelfths of the amount that would be allowed for a full year as there are months in the period covered by the return.
4. The dates on which the period covered by the return begins and ends, if other than the calendar year 1918, must be plainly stated at the head of the return; answers to questions 6, 7, and 7 must be given for that period; and the affidavit must be changed accordingly.

### VI. PERSONAL AND FAMILY EXEMPTION.

1. If you were married and lived with your wife (or husband) or were head of a family in 1918, you may subtract from your net income, before deducting your tax, a family exemption of \$3,000 plus \$200 for each person under 18 (or mentally or physically defective) who received his chief support from you. If husband and wife make separate returns, this exemption may be claimed by either (but not by both) or may be divided between them.
2. If you were not married or did not live with wife (or husband) and were not head of a family in 1918, you are entitled to a personal exemption of \$1,000 plus \$200 for each person under 18 (or mentally or physically defective) who received his chief support from you.
3. If you were entitled to any of the foregoing exemptions during a part of the year only, you may claim as many twelfths of the exemption stated as there were months in such part of the year. Any part of a month may be counted as a month.
4. The personal or family exemption must be reported on line 20, page 1 of the return, and must be supported by answers to questions 6, 7, and 8.
5. A "head of family" is a person who is the chief support of one or more persons living in his household, who are closely related to him (or her) by blood, marriage, or adoption.

### VII. AFFIDAVIT.

1. The affidavit must be executed by the person whose income is reported unless he is a minor or incompetent, or unless he is ill, absent from the country, or otherwise incapacitated, in which case the legal representative or agent may execute the affidavit. However, a minor making his own return may execute the affidavit.
2. The oath will be administered without charge by any collector or deputy collector of internal revenue or by any postmaster or other official of the United States, or by any military or naval officer who is authorized to administer oaths for purposes of military or naval justice and administration. If an internal revenue officer is not available, the return should be sworn to before a notary public, justice of the peace, or other person authorized to administer oaths.

### VIII. WHEN AND WHERE THE RETURN SHOULD BE SENT.

Send your return to the collector of internal revenue for the district in which you live or have your principal place of business so that it will reach him on or before March 15, 1919. If the address of the collector is not printed on the return and you do not know it, ask at the post office or bank.

### IX. WHEN AND TO WHOM THE TAX MUST BE PAID.

1. The tax should be paid, if possible, by sending or bringing with the return a check or money order drawn to the order of "Collector of Internal Revenue at [insert name of city and State]."
2. Do not send cash through the mail, or pay it in person except at the office of the collector or a regularly established internal revenue stamp office.
3. At least one-fourth of the tax is due at the same time that this return is due.
4. An additional amount sufficient to bring the total payments up to one-half of the tax must be paid on or before June 15, 1919.
5. An amount sufficient to bring the total payments up to three-fourths of the tax must be paid on or before September 15, 1919.
6. The entire remainder of the tax must be paid on or before December 15, 1919.
7. If any payment is not made when due, the entire unpaid balance of the tax will become due 10 days after demand therefor by the collector.
8. If you pay in cash, do not fail to get a receipt at the time of payment. If you pay by check or money order, your canceled check or your money order receipt will serve as a receipt.

### X. PENALTIES.

#### For Making False or Fraudulent Return.

Not exceeding \$10,000 or not exceeding one year's imprisonment, or both, in the discretion of the court, and, in addition, 50 per cent of the tax evaded.

#### For Failing to Make Return on Time.

Not more than \$1,000, and, in addition, 50 per cent of the amount of tax due.

#### For Failing to Pay Tax When Due.

Five per cent of the amount due but unpaid, plus 12 per cent interest per annum for the time during which it remains unpaid.

## TABLES AND INSTRUCTIONS FOR CALCULATION OF SURTAX.

SURTAX RATES FOR 1918.

Amount of net income.	Rate.	Amount of net income.	Rate.
A	B	C	D
\$0	0.00	\$10,000	8.10
100	0.00	10,000	8.10
200	0.00	10,000	8.10
300	0.00	10,000	8.10
400	0.00	10,000	8.10
500	0.00	10,000	8.10
600	0.00	10,000	8.10
700	0.00	10,000	8.10
800	0.00	10,000	8.10
900	0.00	10,000	8.10
1,000	0.00	10,000	8.10
1,100	0.00	10,000	8.10
1,200	0.00	10,000	8.10
1,300	0.00	10,000	8.10
1,400	0.00	10,000	8.10
1,500	0.00	10,000	8.10
1,600	0.00	10,000	8.10
1,700	0.00	10,000	8.10
1,800	0.00	10,000	8.10
1,900	0.00	10,000	8.10
2,000	0.00	10,000	8.10
2,100	0.00	10,000	8.10
2,200	0.00	10,000	8.10
2,300	0.00	10,000	8.10
2,400	0.00	10,000	8.10
2,500	0.00	10,000	8.10
2,600	0.00	10,000	8.10
2,700	0.00	10,000	8.10
2,800	0.00	10,000	8.10
2,900	0.00	10,000	8.10
3,000	0.00	10,000	8.10
3,100	0.00	10,000	8.10
3,200	0.00	10,000	8.10
3,300	0.00	10,000	8.10
3,400	0.00	10,000	8.10
3,500	0.00	10,000	8.10
3,600	0.00	10,000	8.10
3,700	0.00	10,000	8.10
3,800	0.00	10,000	8.10
3,900	0.00	10,000	8.10
4,000	0.00	10,000	8.10
4,100	0.00	10,000	8.10
4,200	0.00	10,000	8.10
4,300	0.00	10,000	8.10
4,400	0.00	10,000	8.10
4,500	0.00	10,000	8.10
4,600	0.00	10,000	8.10
4,700	0.00	10,000	8.10
4,800	0.00	10,000	8.10
4,900	0.00	10,000	8.10
5,000	0.00	10,000	8.10
5,100	0.00	10,000	8.10
5,200	0.00	10,000	8.10
5,300	0.00	10,000	8.10
5,400	0.00	10,000	8.10
5,500	0.00	10,000	8.10
5,600	0.00	10,000	8.10
5,700	0.00	10,000	8.10
5,800	0.00	10,000	8.10
5,900	0.00	10,000	8.10
6,000	0.00	10,000	8.10
6,100	0.00	10,000	8.10
6,200	0.00	10,000	8.10
6,300	0.00	10,000	8.10
6,400	0.00	10,000	8.10
6,500	0.00	10,000	8.10
6,600	0.00	10,000	8.10
6,700	0.00	10,000	8.10
6,800	0.00	10,000	8.10
6,900	0.00	10,000	8.10
7,000	0.00	10,000	8.10
7,100	0.00	10,000	8.10
7,200	0.00	10,000	8.10
7,300	0.00	10,000	8.10
7,400	0.00	10,000	8.10
7,500	0.00	10,000	8.10
7,600	0.00	10,000	8.10
7,700	0.00	10,000	8.10
7,800	0.00	10,000	8.10
7,900	0.00	10,000	8.10
8,000	0.00	10,000	8.10
8,100	0.00	10,000	8.10
8,200	0.00	10,000	8.10
8,300	0.00	10,000	8.10
8,400	0.00	10,000	8.10
8,500	0.00	10,000	8.10
8,600	0.00	10,000	8.10
8,700	0.00	10,000	8.10
8,800	0.00	10,000	8.10
8,900	0.00	10,000	8.10
9,000	0.00	10,000	8.10
9,100	0.00	10,000	8.10
9,200	0.00	10,000	8.10
9,300	0.00	10,000	8.10
9,400	0.00	10,000	8.10
9,500	0.00	10,000	8.10
9,600	0.00	10,000	8.10
9,700	0.00	10,000	8.10
9,800	0.00	10,000	8.10
9,900	0.00	10,000	8.10
10,000	0.00	10,000	8.10

SURTAX RATES FOR 1917.

Amount of net income.	Rate.	Amount of net income.	Rate.	Amount of net income.	Rate.
A	B	C	D	E	F
\$0	0%	\$0	0%	\$0	0%
100	0%	100	0%	100	0%
200	0%	200	0%	200	0%
300	0%	300	0%	300	0%
400	0%	400	0%	400	0%
500	0%	500	0%	500	0%
600	0%	600	0%	600	0%
700	0%	700	0%	700	0%
800	0%	800	0%	800	0%
900	0%	900	0%	900	0%
1,000	0%	1,000	0%	1,000	0%
1,100	0%	1,100	0%	1,100	0%
1,200	0%	1,200	0%	1,200	0%
1,300	0%	1,300	0%	1,300	0%
1,400	0%	1,400	0%	1,400	0%
1,500	0%	1,500	0%	1,500	0%
1,600	0%	1,600	0%	1,600	0%
1,700	0%	1,700	0%	1,700	0%
1,800	0%	1,800	0%	1,800	0%
1,900	0%	1,900	0%	1,900	0%
2,000	0%	2,000	0%	2,000	0%
2,100	0%	2,100	0%	2,100	0%
2,200	0%	2,200	0%	2,200	0%
2,300	0%	2,300	0%	2,300	0%
2,400	0%	2,400	0%	2,400	0%
2,500	0%	2,500	0%	2,500	0%
2,600	0%	2,600	0%	2,600	0%
2,700	0%	2,700	0%	2,700	0%
2,800	0%	2,800	0%	2,800	0%
2,900	0%	2,900	0%	2,900	0%
3,000	0%	3,000	0%	3,000	0%
3,100	0%	3,100	0%	3,100	0%
3,200	0%	3,200	0%	3,200	0%
3,300	0%	3,300	0%	3,300	0%
3,400	0%	3,400	0%	3,400	0%
3,500	0%	3,500	0%	3,500	0%
3,600	0%	3,600	0%	3,600	0%
3,700	0%	3,700	0%	3,700	0%
3,800	0%	3,800	0%	3,800	0%
3,900	0%	3,900	0%	3,900	0%
4,000	0%	4,000	0%	4,000	0%
4,100	0%	4,100	0%	4,100	0%
4,200	0%	4,200	0%	4,200	0%
4,300	0%	4,300	0%	4,300	0%
4,400	0%	4,400	0%	4,400	0%
4,500	0%	4,500	0%	4,500	0%
4,600	0%	4,600	0%	4,600	0%
4,700	0%	4,700	0%	4,700	0%
4,800	0%	4,800	0%	4,800	0%
4,900	0%	4,900	0%	4,900	0%
5,000	0%	5,000	0%	5,000	0%
5,100	0%	5,100	0%	5,100	0%
5,200	0%	5,200	0%	5,200	0%
5,300	0%	5,300	0%	5,300	0%
5,400	0%	5,400	0%	5,400	0%
5,500	0%	5,500	0%	5,500	0%
5,600	0%	5,600	0%	5,600	0%
5,700	0%	5,700	0%	5,700	0%
5,800	0%	5,800	0%	5,800	0%
5,900	0%	5,900	0%	5,900	0%
6,000	0%	6,000	0%	6,000	0%
6,100	0%	6,100	0%	6,100	0%
6,200	0%	6,200	0%	6,200	0%
6,300	0%	6,300	0%	6,300	0%
6,400	0%	6,400	0%	6,400	0%
6,500	0%	6,500	0%	6,500	0%
6,600	0%	6,600	0%	6,600	0%
6,700	0%	6,700	0%	6,700	0%
6,800	0%	6,800	0%	6,800	0%
6,900	0%	6,900	0%	6,900	0%
7,000	0%	7,000	0%	7,000	0%
7,100	0%	7,100	0%	7,100	0%
7,200	0%	7,200	0%	7,200	0%
7,300	0%	7,300	0%	7,300	0%
7,400	0%	7,400	0%	7,400	0%
7,500	0%	7,500	0%	7,500	0%
7,600	0%	7,600	0%	7,600	0%
7,700	0%	7,700	0%	7,700	0%
7,800	0%	7,800	0%	7,800	0%
7,900	0%	7,900	0%	7,900	0%
8,000	0%	8,000	0%	8,000	0%
8,100	0%	8,100	0%	8,100	0%
8,200	0%	8,200	0%	8,200	0%
8,300	0%	8,300	0%	8,300	0%
8,400	0%	8,400	0%	8,400	0%
8,500	0%	8,500	0%	8,500	0%
8,600	0%	8,600	0%	8,600	0%
8,700	0%	8,700	0%	8,700	0%
8,800	0%	8,800	0%	8,800	0%
8,900	0%	8,900	0%	8,900	0%
9,000	0%	9,000	0%	9,000	0%
9,100	0%	9,100	0%	9,100	0%
9,200	0%	9,200	0%	9,200	0%
9,300	0%	9,300	0%	9,300	0%
9,400	0%	9,400	0%	9,400	0%
9,500	0%	9,500	0%	9,500	0%
9,600	0%	9,600	0%	9,600	0%
9,700	0%	9,700	0%	9,700	0%
9,800	0%	9,800	0%	9,800	0%
9,900	0%	9,900	0%	9,900	0%
10,000	0%	10,000	0%	10,000	0%
10,100	0%	10,100	0%	10,100	0%
10,200	0%	10,200	0%	10,200	0%
10,300	0%	10,300	0%	10,300	0%
10,400	0%	10,400	0%	10,400	0%
10,500	0%	10,500	0%	10,500	0%
10,600	0%	10,600	0%	10,600	0%
10,700	0%	10,700	0%	10,700	0%
10,800	0%	10,800	0%	10,800	0%
10,900	0%	10,900	0%	10,900	0%
11,000	0%	11,000	0%	11,000	0%
11,100	0%	11,100	0%	11,100	0%
11,200	0%	11,200	0%	11,200	0%
11,300	0%	11,300	0%	11,300	0%
11,400	0%	11,400	0%	11,400	0%
11,500	0%	11,500	0%	11,500	0%
11,600	0%	11,600	0%	11,600	0%
11,700	0%	11,700	0%	11,700	0%
11,800	0%	11,800	0%	11,800	0%
11,900	0%	11,900	0%	11,900	0%
12,000	0%	12,000	0%	12,000	0%
12,100	0%	12,100	0%	12,100	0%
12,200	0%	12,200	0%	12,200	0%
12,300	0%	12,300	0%	12,300	0%
12,400	0%	12,400	0%	12,400	0%
12,500	0%	12,500	0%	12,500	0%
12,600	0%	12,600	0%	12,600	0%
12,700	0%	12,700	0%	12,700	0%
12,800	0%	12,800	0%	12,800	0%
12,900	0%	12,900	0%	12,900	0%
13,000	0%	13,000	0%	13,000	0%
13,100	0%	13,100	0%	13,100	0%
13,200	0%	13,200	0%	13,200	0%
13,300	0%	13,300	0%	13,300	0%
13,400	0%	13,400	0%	13,400	0%
13,500	0%	13,500	0%	13,500	0%
13,600	0%	13,600	0%	13,600	0%
13,700	0%	13,700	0%	13,700	0%
13,800	0%	13,800	0%	13,800	0%
13,900	0%	13,900	0%	13,900	0%
14,000	0%	14,000	0%	14,000	0%
14,100	0%	14,100	0%	14,100	0%
14,200	0%	14,200	0%	14,200	0%
14,300	0%	14,300	0%	14,300	0%
14,400	0%	14,400	0%	14,400	0%
14,500	0%	14,500	0%	14,500	0%
14,600	0%	14,600	0%	14,600	0%
14,700	0%	14,700	0%	14,700	0%
14,800	0%	14,800	0%	14,800	0%
14,900	0%	14,900	0%	14,900	0%
15,000	0%	15,000	0%	15,000	0%
15,100	0%	15,100	0%	15,100	0%
15,200	0%	15,200	0%	15,200	0%
15,300	0%	15,300	0%	15,300	0%
15,400	0%	15,400	0%	15,400	0%
15,500	0%	15,500	0%	15,500	0%
15,600	0%	15,600	0%	15,600	0%
15,700	0%	15,700	0%	15,700	0%
15,800	0%	15,800	0%	15,800	0%
15,900	0%	15,900	0%	15,900	0%
16,000	0%	16,000	0%	16,000	0%
16,100	0%	16,100	0%	16,100	0%
16,200	0%	16,200	0%	16,200	0%
16,300	0%	16,300	0%	16,300	0%
16,400	0%	16,400	0%	16,400	0%
16,500	0%	16,500	0%	16,500	0%
16,600	0%	16,600	0%	16,600	0%
16,700	0%	16,700	0%	16,700	0%
16,800	0%	16,800	0%	16,800	0%
16,900	0%	16,900	0%	16,900	0%
17,000	0%	17,000	0%	17,000	0%
17,100	0%	17,100	0%	17,100	0%
17,200	0%	17,200	0%	17,200	0%
17,300	0%	17,300	0%	17,300	0%
17,400	0%	17,400	0%	17,400	0%
17,500	0%	17,500	0%	17,500	0%
17,600	0%	17,600	0%	17,600	0%
17,700	0%	17,700	0%	17,700	0%
17,800	0%	17,800	0%	17,800	0%
17,900	0%	17,900	0%	17,900	0%
18,000	0%	18,000	0%	18,000	0%
18,100	0%	18,100	0%	18,100	0%
18,200	0%	18,200	0%	18,200	0%
18,300	0%	18,300	0%	18,300	0%
18,400	0%	18,400	0%	18,400	0%
18,500	0%	18,500	0%	18,500	0%
18,600	0%	18,600	0%	18,600	0%
18,700	0%	18,700	0%	18,700	0%
18,800	0%	18,800	0%	18,800	0%
18,900	0%	18,900	0%	18,900	0%
19,000	0%	19,000	0%	19,000	0%
19,100	0%	19,100	0%	19,100	0%
19,200	0%	19,200	0%	19,200	0%
19,300	0%	19,300	0%	19,300	0%
19,400	0%	19,400	0%	19,400	0%
19,500	0%	19,500	0%	19,500	0%
19,600	0%	19,600	0%	19,600	0%
19,700	0%	19,700	0%	19,700	0%
19,800	0%	19,800	0%	19,800	0%
19,900	0%	19,900	0%	19,900	0%
20,000	0%	20,000	0%	20,000	0%
20,100	0%	20,100	0%	20,100	0%
20,200	0%	20,200	0%	20,200	0%
20,300	0%	20,300	0%	20,300	0%
20,400	0%	20,400	0%	20,400	0%
20,500	0%	20,500	0%	20,500	0%
20,600	0%	20,600	0%	20,600	0%
20,700	0%	20,700	0%	20,700	0%
20,800	0%	20,800	0%	20,800	0%
20,900	0%	20,900	0%	20,900	0%
21,000	0%	21,000	0%	21,000	0%
21,100	0%	21,100	0%	21,100	0%
21,200	0%	21,200	0%	21,200	0%
21,300	0%	21,300	0%	21,300	0%
21,400	0%	21,400	0%	21,400	0%
21,500	0%	21,500	0%	21,500	0%
21,600	0%	21,600	0%	21,600	0%
21,700	0%	21,700	0%	21,700	0%
21,800	0%	21,800	0%	21,800	0%
21,900	0%	21,900	0%	21,900	0%
22,000	0%	22,000	0%	22,000	0%
22,100	0%	22,100	0%	22,100	0%
22,200	0%	22,200	0%	22,200	0%
22,300	0%	22,300	0%	22,300	0%
22,400	0%	22,400	0%	22,400	0%
22,500	0%	22,500	0%	22,500	0%
22,600	0%	22,600	0%	22,600	0%
22,700	0%	22,700	0%	22,700	0%
22,800	0%	22,800	0%	22,800	0%
22,900	0%	22,900	0%	22,900	0%
23,000					

# INSTRUCTIONS FOR FILLING IN TAXABLE INCOME

If the form has not been changed, all entries, with different colors, on a separate sheet of paper and attach it to the return.

## A. INCOME FROM BUSINESS OR PROFESSION.

Report here income from—

- (a) Sale of merchandise, or of products of manufacturing, construction, mining, and agriculture. (The farm income see Instruction IV on the other side of this sheet.)
- (b) Business enterprise, including, but not limited to, retail and restaurant service, delivery and garage service, etc., if you owned the business. If you were engaged in the business as an employee, report your salary or wages in Schedule B.
- (c) A profession, trade, or service, if you practiced or performed it on your own account. If you were employed on a salary, report your salary in Schedule B.

In general, report in Schedule A any income in the earning of which you incurred expenses for labor, rent, etc. Do not report here partnership profits or profits of personal service corporations, which should be entered under K(a), or dividends from other corporations, which should be entered under K(a).

If you are a farmer (or a person engaged in your farm to another person on share), enter on line 21 your net income from farming, as shown by your "Schedule of Farm Income and Expenses."

Kind of business.—State kind of goods dealt in or kind of services rendered, and whether manufacturer, jobber, wholesaler, retailer, importer, broker, etc.

If you keep books showing income accrued, report such income instead of cash received, and report expenses incurred instead of expenses paid.

Income received from sale of lands, buildings, equipment, stocks, bonds, and other property not dealt in as a business should be reported under D.

If you have a complete profit and loss statement, showing all the information called for under "Cost of goods sold" and "Other business deductions," attach it to the return and enter the amount of net income on line 21, Schedule A.

Total sales and income from business or profession.—Report the total amount derived from sales or from services, less any discounts or allowances from the sale price or service charges.

Investments.—If investments were taken at cost, write "C" on line 8, immediately before the amount column; if at cost or market, whichever is lower, write "C or M."

Other business deductions.—Do not include cost of depreciation on equipment or furniture, expenditures for permanent improvements, or living and family expenses. Do not deduct interest on your own investment in your business, or salary or wages for your own service or the service of your family, unless these items are included in income in Schedule B or in deduction in Schedule C.

Rest.—Report here rent for business property (not including rent for dwelling or vacation property).

Interest.—Report here interest on business indebtedness, including indebtedness incurred to purchase or carry business property.

Taxes.—Do not include taxes on business property or for carrying on business. Do not include taxes assessed on and against business property or living and family expenses of the business, as for paving, sewers, etc., nor Federal income taxes.

Repairs, wear and tear, obsolescence, and depreciation.—Report here (a) ordinary repairs required to maintain condition, (b) depreciation during the year.

Report in Schedule B salary received from partnership or personal service corporation.

Report in Schedule D salary received from partnership or personal service corporation.

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on business property only to the extent not offset by repairs, replacements, or losses claimed as deductions in this or previous returns, (c) reasonable allowance for obsolescence (if any) of business property for which no deduction has been claimed elsewhere, or (d) depreciation on business property, or (e) previous returns for fire, storm, or other casualty, or theft, not compensated for by insurance or otherwise, and not made good by repairs or replacements claimed as deductions. Explain these deductions in detail on a separate sheet of page 2 of the return.

Any loss of property not used in your business, such as your dwelling or home-hold furniture, should be reported in Schedule I.

The amount claimed for wear and tear or depreciation should not exceed the original cost of the property (or its value March 1, 1913, if acquired before that date) divided by its total estimated life in years. When the amount of depreciation is equal to the cost of the property (or its value March 1, 1913), no further claim should be made.

Do not claim any deduction for depreciation in the value of a building occupied by the owner as his dwelling, or of other property held for personal use. Do not claim deduction for depreciation of real estate (exclusive of improvements thereon), nor for depreciation of stocks, bonds, and other securities.

Do not claim depreciation or losses of articles that have been taken into your inventory at a figure reflecting the reduction in value.

Depreciation of patents, copyrights, etc., and depletion of mines, etc.—If you wish to claim a deduction on account of depreciation in the value of patents, copyrights, franchises, and other legal privileges, or on account of depletion of mines and oil and gas wells, see the income and profits tax regulations.

Bad debts.—Report only debts which you have ascertained to be worthless and have written off after the year closed.

A bad debt offsetting income accrued since March 1, 1913, will not be allowed as a deduction unless the amount was reflected in the income reported for the year in which the debt was created.

State under "Explanation of deductions," at the foot of the page, how the debts were ascertained to be worthless, or if the deduction is based on a reserve, state especially the basis on which such reserve has been computed. Involvement of the debtor, inability to collect by legal proceedings, or inability of debtor to pay, ascertained by a mercantile agency, would be a sufficient indication of worthlessness.

Unpaid debts are not deductible if made good by recovery of property sold or recovery of property pledged.

Bad debts arising out of personal loans should be reported in Schedule I.

Other expenses.—Do not include your personal exemption here. This is to be reported in Schedule I.

Net loss.—If the net cost of goods sold plus other business deduction is in excess of the total amount of sales and income from business or professional service, report the net loss in column 6 by entering net loss or a minus.

BONUS, DIRECTOR'S FEES, AND PENSIONS.

Do not report here pay, not exceeding \$3,500, for active service in the Army or Navy (see Instruction III, paragraph 1, on the other side of this sheet). Report such pay in table II, part 1 of the return.

Expenses.—Enter in the space at the foot of page 2 of the return.

Appropriation of partnership income.—If you share in the income from a partnership whose fiscal year differed from the calendar year, assign to 1917 as many twelfths of your share of the partnership's income (except stock dividends and Liberty Bonds) as the number of months of the partnership's income deductible on the partnership's fiscal year that fell in the calendar year 1917. Assign to 1918 the remainder of your share of the partnership's income, except stock dividends and Liberty Bonds interest, which should be ascertained as provided in Instructions under K(a) and K(b) below.

Cost.—Enter the original cost of the property or, if it was acquired before March 1, 1913, its fair market value on that date. Expense incidental to the purchase may be deducted from the original cost of the property.

Enter in column 7 the amount of wear and tear, obsolescence, or depletion sustained since March 1, 1913 (or since date of acquisition if subsequent to March 1, 1913). (This is a deduction from the original cost of the property as an addition to the sale price.)

Lesses.—If the total of columns 5 and 6 is in excess of the total of column 4 and 7, report the difference as a loss by using net loss or a minus sign.

Other expenses and losses.—Report losses on rented or leased property and losses on obsolescence incurred or continued to purchase or carry it. Do not include taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

Interest.—Report here interest paid on personal indebtedness as distinguished from business indebtedness (which should be reported under A, E, or G above). Do not include interest on indebtedness incurred for the purchase of bonds and other securities, the interest on which is exempt from tax, except interest on indebtedness incurred to purchase or carry obligations of the United States. See Instruction III, paragraph 1, for a list of obligations exempt from tax.

Taxes.—Report here taxes on your dwelling and household property, not including those assessed against local benefits of a kind tending to increase the value of the property. Do not include Federal income taxes.

Losses.—Report here losses of property not connected with your trade, business, or profession, sustained during the year from fire, storm, shipwreck, or other casualty, or from theft, which were not compensated for by insurance or otherwise. Explain such losses in table at foot of page 2 of return.

Stock dividends which were paid out of profit or surplus accumulated by the distributing corporation prior to the year for which the return is made but not prior to March 1, 1913, should not be reported here, but in column 6 of the return. See Item 13, a, b, and c, Item 14b, col. 4, and Items 14c and 14d on page 1 of the return.

Profits of personal service corporations should be included in C (except such profits as consisted of dividends of ordinary corporations and interest on obligations of the United States issued since September 1, 1917).

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## RETURN OF INCOME TAXABLE AT 1918 RATES

A. INCOME FROM BUSINESS OR PROFESSION.									
1. Kind of business		2. Business address							
3. Total sales and income from business or professional services									
COST OF GOODS SOLD:									
4. Labor		OTHER BUSINESS DEDUCTIONS:							
5. Material and supplies		12. Salaries and wages not reported as "Labor" under "Cost of Goods Sold"							
6. Merchandise bought for sale		13. Rent							
7. Other costs (submit schedule of principal items at foot of page or on separate sheet)		14. Interest on business indebtedness							
8. Plus inventories at beginning of year		15. Taxes on business and business property							
9. TOTAL		16. Repairs, wear and tear, obsolescence, depletion, and property losses (explain in table below)							
10. Less inventories at end of year		17. Bad debts arising from sales							
11. NET COST OF GOODS SOLD		18. Other expenses (submit schedule of principal items at foot of page or on separate sheet)							
12. NET COST OF GOODS SOLD PLUS OTHER BUSINESS DEDUCTIONS		19. TOTAL OTHER BUSINESS DEDUCTIONS							
20. NET INCOME FROM BUSINESS OR PROFESSION									
B. INCOME FROM SALARIES, WAGES, COMMISSIONS, BONUSES, DIRECTOR'S FEES, AND PENSIONS.									
1. OCCASION		2. NAME AND ADDRESS OF EMPLOYER				3. GROSS INCOME		4. DEDUCTIONS, IF ANY	
NET INCOME FROM SALARIES, ETC. (total of column 3 minus total of column 4)									
C. INCOME FROM PARTNERSHIPS, PERSONAL SERVICE CORPORATIONS, AND ESTATES AND TRUSTS (not including interest on tax-free government bonds received through Administrator, which should be included in Item F; dividends, which should be included in Item K(a); taxable interest on obligations of the U. S., which should be included in Item K(b); or income taxable at 1917 or earlier rates—see table in page 1)									
D. PROFIT FROM SALE OF LAND, BUILDINGS, STOCKS, BONDS, AND OTHER PROPERTY.									
1. KIND OF PROPERTY		2. YEAR ACQUIRED		3. NAME AND ADDRESS OF PURCHASER OR TRADER		4. SALE PRICE		5. ORIGINAL COST OR MARKET VALUE MAR. 1, 1913	
								6. COST OF STAMPESS, EXCESS INVESTMENT, IF ANY	
								7. DEPRECIATION, DEPLETION, IF ANY	
NET PROFIT FROM SALES (total of column 4 and 7 minus total of column 5 and 6)									
E. INCOME FROM RENTS AND ROYALTIES.									
1. KIND OF PROPERTY		2. NAME AND ADDRESS OF TENANT, LESSEE, ETC.		3. AMOUNT OF RENT AND ROYALTIES		4. REPAIRS, WEAR AND TEAR, OBsolescence, DEPLETION, AND PROPERTY LOSSES		5. INTEREST	
								6. TAXES	
								7. OTHER DEDUCTIONS (EXPLAIN BELOW)	
NET INCOME FROM RENTS AND ROYALTIES (total of column 3 minus total of column 4, 5, 6, and 7)									
F. INTEREST ON CORPORATION BONDS CONTAINING TAX-FREE COVENANT, ON WHICH A TAX OF 2% WAS PAID BY DEBTOR CORPORATION (including such interest received through fiduciaries).									
G. OTHER INCOME (not including dividends, or interest on obligations of the United States).									
1. Interest on bonds, mortgages, and other obligations of domestic and resident corporations except as reported in Item F		2. Gross income							
2. Interest on bonds of foreign countries and corporations and dividends on stock of foreign corporations		3. Deductions, if any							
3. Interest on bank deposits, mortgages, etc.									
4.									
5.									
NET TOTAL (total of column 1 minus total of column 2)									
H. TOTAL NET INCOME FROM ABOVE SOURCES									
I. GENERAL DEDUCTIONS NOT INCLUDED ABOVE.									
1. Interest paid or accrued		2. Losses by fire, storm, etc. (explain in table below)		3. Other deductions, if any (explain below)					
2. Taxes paid or accrued		4. Contributions (explain below)		Total					
J. Total net income on which normal tax is to be calculated at 1918 rates (H minus I) (enter as 25, page 1)									
K(a). Dividends on stock of corporations organized or doing business in the United States (not including income from personal service corporations):									
Received directly, \$ _____; received through partnerships, personal service corporations, and fiduciaries, \$ _____ Total									
K(b). Taxable interest on bonds and other obligations of the United States issued after September 1, 1917 (see instructions, page 2)									
L. Total net income subject to surtax at 1918 rates (if this amount is \$5,000 or less, make your return on Form 1040A, unless you had income taxable at 1917 or earlier rates)									
ENTER IN THIS TABLE DETAILS CONCERNING REPAIRS, WEAR AND TEAR, PROPERTY LOSSES, ETC., CLAIMED AS DEDUCTIONS IN SCHEDULES A, E, AND I ABOVE.									
1. REPAIRS, WEAR AND TEAR, ETC.		2. KIND OF PROPERTY (IF BUILDING, STATE ALSO MATERIALS OF WHICH COMPOSED)		3. YEAR ACQUIRED		4. COST OF PROPERTY (ON MARKET VALUE MAR. 1, 1913)		5. REPAIRS (NOT COVERED BY CLAIMS FOR WEAR AND TEAR AND LOSS)	
								6. REPAIRS	
								7. AMOUNT FOR YEAR	
								8. AMOUNT FOR YEAR	
								9. CLAIM OF LOSS	
								10. AMOUNT OF LOSS	
EXPLANATION OF DEDUCTIONS claimed in Schedule A, lines 7 and 18; Schedule B, column 4; Schedule C, column 7; Schedule D, column 2; and Schedule I, items 4 and 5.									

SUGGESTED DRAFT STATEMENT TO BE PREPARED BY INDIVIDUAL TAXPAYER BEFORE FILLING  
IN FORM 1040

UNMARRIED—SUBJECT TO SURTAX. CALENDAR YEAR—CASH BASIS.

PAGE		ITEM	DETAILS OF INCOME:		
57			Gift from father.....	<u>\$1,000.00</u>	Do not report
200	B-Col. 3		Salary from firm.....	<u>\$8,000.00</u>	
200	B-Col. 3		Salary as officer of corporation.....	7,000.00	
200	B-Col. 3		Fees as director.....	200.00	
206	B-Col. 3		Bonus from corporation (not a gift).....	<u>2,800.00</u>	\$18,000.00
401	B-Col. 4		Deduction for business (not partnership) expenses.....	<u>1,700.00</u>	\$16,300.00
217	D		Profit on sales of stocks.....	<u>\$3,000.00</u>	
499	D		Deduction for losses on sales of stocks, actual losses.....	<u>2,500.00</u>	500.00
318	E-Col. 3		Rents.....	<u>\$2,200.00</u>	
442	E-Col. 7		Deduction for real estate expenses.....	\$400.00	
432	E-Col. 5		Deduction for interest on mortgages.....	600.00	
404	E-Col. 6		Deduction for real and personal property taxes.....	200.00	
535	E-Col. 3		Deduction for depreciation (buildings only).....	600.00	400.00
475			Taxes account opening of new street.....	<u>\$50.00</u>	Do not deduct
205	11		Interest on First Liberty Bonds, 3½%.....	<u>\$350.00</u>	Do not report
296	13 (a)		Interest on Second Liberty Bonds, 4% (Principal \$45,000).....	<u>\$1,800.00<sup>1</sup></u>	Do not report
296	13 (b)		Interest on Third Liberty Bonds, 4¼% (Principal \$5,000).....	<u>\$74.50<sup>2</sup></u>	Do not report

PAGE	ITEM		
327	K (a)	Cash dividends.....	16,000.00
350		Stock dividends received July 1, 1918, declared from Surplus accrued prior to March 1, 1913.....	Do not report
			<u>\$15,000.00</u>
376	14-3 & K (a)	Cash dividends received through partnership.....	24,000.00
315	F	Interest on corporate bonds containing "tax-free" provision.....	2,000.00
293	G-1	Interest on corporate bonds containing no "tax-free" provision.....	1,000.00
307	G-3	Interest on bank deposits.....	200.00
370	14-7 & C	As partner, distributive share, not including partner's share of dividends and interest on U. S. obligations received by firm.....	45,000.00
			<u>\$106,000.00</u>
		Total Net Income.....	
		General deductions not claimed above:	
448	I-1	Deduction for interest on loan.....	\$200.00
	I-1	Deduction for interest on money borrowed to purchase and carry Second, Third and Fourth Liberty Bonds.....	675.00
475	I-2	Deduction for taxes on dwelling house.....	300.00
519	I-5	Bad debt.....	200.00
			<u>1,375.00</u>
		Total Net Income (before deducting contributions).....	<u>\$104,625.00</u>
		Total amount contributed to charities, etc., during 1918 (to be supported by schedule).....	
		Amount allowable is 15 per cent of net taxable income:	
		Net income as above.....	<u>\$16,000.00</u>
		15 per cent thereof.....	<u>\$104,625.00</u>
424	I-4	Amount subject to Surtax.....	15,693.75
325	L & 15 K (a)	Credit cash dividends direct.....	\$88,931.25
325	K (a)	Credit cash dividends—received through partnership.....	\$16,000.00
			<u>24,000.00</u>
			<u>40,000.00</u>

<sup>1</sup>Interest is exempt owing to \$30,000 Fourth Liberty Bonds being originally subscribed for and still held.  
<sup>2</sup>Interest to extent of \$5,000 of principal of any issue, exempt.



PAGE	ITEM		
25		Amount subject to normal tax.....	\$48,931.25
46	26	Specific Exemption.....	1,000.00
	27	Balance .....	<u>\$47,931.25</u>
112	28	Amount subject to tax at 6% (not over \$4,000).....	4,000.00
112	29	Balance subject to tax at 12%.....	<u>\$43,931.25</u>
33	33	Normal Tax at 6%.....	\$ 240.00
34	34	Normal Tax at 12%.....	<u>5,271.75</u>
			<u>\$5,511.75</u>
161	36	Surtax:	
		\$5,000.00 exempt.....	Nil
		83,000.00 at 1% to 37%.....	\$18,050.00
		931.25 at 43%.....	<u>400.44</u>
	38	<u>\$88,931.25</u>	
315	39	Total Tax.....	\$23,962.19
		Less: Tax paid at source (2% of item F).....	<u>40.00</u>
	41	Balance of Tax due.....	<u>\$23,922.19</u>

## INDIVIDUAL TAXPAYER

RETIRED MANUFACTURER—MARRIED—NO NORMAL TAX—SUBJECT TO  
SURTAX—STOCK DIVIDENDS RECEIVED DIRECT

## FORM 1040

CHAP- TER	SCHEDULE & ITEM			
XXIX	C	Income from Trust:		\$ 200.00
		Cash from Trust Fund.....		
X	D	Profit from Sale of Property:		
	D-Col. 5	Cost of apartment house purchased January 1, 1917, for investment, sold June 30, 1918 .....	\$50,000.00	
	D-Col. 6	Electric light plant added in 1917.....	6,000.00	
			<hr/>	
XXIV	D-Col. 7	Depreciation .....	\$56,000.00	
			1,500.00	
			<hr/>	
	D-Col. 4	Selling price .....	\$54,500.00	
			60,000.00	
			<hr/>	
	D	Net Profit from Sale of Property.....		5,500.00
XIV	E	Income from Rents:		
	E-Col. 3	Rentals from apartment house, 6 months.....	\$ 2,500.00	
XXIV	E-Col. 4	Repairs \$200 and depreciation \$500.....	\$700.00	
XX	E-Col. 5	Interest on \$30,000 mortgage, 6 months.....	900.00	
XXI	E-Col. 6	Taxes .....	400.00	
XIX	E-Col. 7	Janitor's wages, light, heat, etc.....	400.00	
			<hr/>	
	E	Net Income from Rents.....		100.00
XIII	F	Interest on Tax-Free Bonds (exemption not claimed):		
		From bonds held in Trust Fund.....	\$ 100.00	
		From bonds owned personally.....	2,000.00	
			<hr/>	
				2,100.00

CHAP- TER	SCHEDULE & ITEM			
XIII	G	Other Income:		
	G-1	Interest on bonds (not tax-free), mortgages, etc.	\$4,500.00	
		Less: Accrued interest on bonds purchased	100.00	\$4,400.00
XIII	G-2	Interest on Anglo-French 5's	250.00	
XIII	G-3	Interest on bank deposits	300.00	
X	G-4	Bridge whist club winnings (net)	250.00	
	G	Total Other Income		5,200.00
	H	Total Net Income from above Sources		\$13,100.00
	I	General Deductions Not Included Above:		
XX	I-1	Interest on all personal loans		\$ 500.00
XXI	I-2	Taxes—State income tax	\$2,000.00	
		—Taxes on dwellings	200.00	
		—Automobile licenses	30.00	2,230.00
XX	I-3	Pergola on his estate destroyed by storm	300.00	
XIX	I-4	Contributions—total \$7,500, but not fully deductible as this item must not exceed 15% of net income without this deduction	6,917.25	
XX	I-5	Loss on third mortgage bonds of X Y Z Railroad, bankrupt and no dividends possible to bondholders of this class—cost	5,000.00	
	I	Total General Deductions		14,947.25
	J	Total Net Income on which Normal Tax is to be calculated at 1918 rates; in this case a loss designated by minus sign		— \$1,847.25
XV	K (a)	Cash Dividends on Stock of Corporations: Received directly Received through Trust Fund	\$41,000.00 45.00	
	K (a)	Total Cash Dividends Received		41,045.00
L	L	Total Net Income subject to Surtax at 1918 rates		\$39,197.75

There is no normal tax as Item J represents a loss. This taxpayer, however, is subject to surtax.

## Amount of Stock Dividends Received:

12 (a)	Accumulated in 1917	\$ 500.00
12 (b)	Accumulated in 1916	300.00
12 (c)	Accumulated since February 28, 1913, and before January 1, 1916	1,000.00

## IV

## CALCULATION OF SURTAX

15	Item L, page 2	\$39,197.75	Subject to surtax at 1918 rates
16	Item 12 (a)	500.00	Stock dividend accumulated in 1917
18	Total (Items 15 and 16)	\$39,697.75	
19	Item 12 (b)	300.00	Stock dividend accumulated in 1916
21	Total (Items 18 and 19)	\$39,997.75	
22	Item 12 (c)	1,000.00	Stock dividend accumulated in 1913-14-15
24	Total Net Income (Items 21 and 22)	\$40,997.75	

## CALCULATION, AT 1918 RATES

\$39,197.25 (item 15)—Tax on \$38,000 per table	\$3,050.00
Tax on \$1,197.75 at 18%	215.60
Surtax at 1918 rates	\$3,265.60

## CALCULATION AT 1917 RATES

\$500.00 (item 16) at 8%	\$ 40.00
(Bracket \$20,000 to \$40,000 in surtax schedule for 1917 is taxable at 8%)	

## CALCULATION AT 1916 RATES

\$300.00 (item 19) at 1%	3.00
(Bracket \$20,000 to \$40,000 in surtax schedule for 1916 is taxable at 1%)	

## CALCULATION AT 1913-1915 RATES

\$1,000.00 (item 22) at 1%	10.00
(Bracket \$20,000 to \$50,000 in surtax schedule for 1913-1915 is taxable at 1%)	

27	Surtax at prior-year rates	53.00
38	Total Tax	\$3,318.60
39	Credit for tax paid at source (2% of item F, page 2)	42.00
41	Balance of Tax Due	\$3,276.60

## XIII

NOTE: Taxpayer's wife has an independent income and makes a separate return, claiming the entire personal exemption of \$2,000.

## INDIVIDUAL TAXPAYER

MERCHANT—MARRIED—SUBJECT TO SURTAX—LIBERTY BOND INTEREST

FORM 1040

CHAP-  
TER  
& ITEM  
SCHEDULE

Income from Business:

Net profit from business conducted by merchant as sole proprietor.....  
*Add:* Contribution to Red Cross charged on merchant's books as business  
 expense (deducted below).....

\$16,500.00  
 200.00

Business net income subject to tax.....

\$16,700.00

Income from Salaries, etc.:

Salary as Treasurer of Retail Merchants' Association .....  
*Deduct:* Expenses of stationery, postage, etc., incurred as Treasurer.....

\$ 500.00  
 125.00

Net income from salaries.....

375.00

Profit from Sale of Land, Buildings, Stocks, etc.:

Stock acquired 1910—Market value March 1, 1913.....  
 Sold in 1918 for.....

\$ 2,600.00  
 1,800.00

Net loss (designated by minus sign).....

—800.00

Other Income:

Interest on bonds—Consumers' Electric Lighting Co.....  
 Interest on bonds of Great Britain & Ireland.....  
 Interest on mortgage note and bank deposits.....

\$ 100.00  
 110.00  
 75.00

Other Income totaled.....

285.00

Total Net Income from Above Sources.....

\$16,560.00

General Deductions not included above:

Interest paid on all personal loans.....  
*Less:* Interest on those loans made to purchase and carry municipal bonds,  
 interest on which is tax-exempt.....

\$ 570.00  
 160.00

Interest .....

\$ 410.00

1040

CHAP- SCHEDULE  
TER & ITEM

Tax on dwelling house.....\$300.00  
Taxes on railroad fares for vacation trip (regular fare tickets \$150.00  
× .074, and Pullman fares \$22.00 × .0909)..... 13.09

I - 2

Taxes

313.09

XIX

Personal Contributions to Red Cross.....\$300.00  
Contribution made by business, as above..... 200.00

I - 4

Contributions

500.00

I

General Deductions Totaled

1,223.09

I

Total net income subject to normal tax.....

XV K (a)

Cash Dividends Received.....

\$15,336.91

XIII K (b)

Taxable interest on obligations of U. S. issued after September 1, 1917 (see  
supplementary statement below).....

625.00

L

Total net income subject to surtax.....

223.50

1041

ITEM 13—LIBERTY BOND INTEREST (CHAPTER XIII)

I. CLASS OF OBLIGATION

INDIVIDUAL HOLDINGS

7. MAXIMUM EXEMPTION  
(as printed on the form)

2. AMOUNT OF INTEREST

3. MAXIMUM AMOUNT OF OBLIGATIONS

(a) 2nd Liberty Loan

\$400.00 \$10,000.00

(b) 3rd Liberty Loan

\$596.00 \$40,000.00

\$45,000 { In addition,  
\$5,000.

NOTE: Amount of bonds of 4th Liberty Loan originally subscribed for was \$30,000, of which the amount owned at date  
of tax return was \$20,000.

TOTAL NET INCOME SUBJECT TO NORMAL TAX

ITEM

25 Net income shown on page 2, item J.....

\$15,336.91

26 Less personal exemption.....

2,000.00

27 Balance .....

\$13,336.91

28 Amount subject to tax at 6%.....

4,000.00

29 Balance subject to tax at 12%.....

9,336.91

## ITEM

## CALCULATION OF TAX

33	Normal tax of 6% on amount of item 28.....	\$240.00
34	" " " 12% " " 29.....	1,120.43
36	Surtax at 1918 rates on amount of item L.....	422.98
	Total tax.....	<u>\$1,783.41</u>

## DETAILS OF SURTAX CALCULATION (CHAPTER IV)

Amount subject to surtax at 1918 rates (item L).....		Tax
Amount over \$ 5,000 and under \$ 6,000	1%.....	\$ 1,000.00
" " " 6,000 " 8,000	2 ".....	2,000.00
" " " 8,000 " 10,000	3 ".....	2,000.00
" " " 10,000 " 12,000	4 ".....	2,000.00
" " " 12,000 " 14,000	5 ".....	2,000.00
" " " 14,000 " 16,000	6 ".....	2,000.00
" " " 16,000 " 18,000	7 ".....	185.41
Total income over \$5,000.....		<u>\$ 11,185.41</u>
		<u>\$422.98</u>

\$16,185.41

\$ 10.00  
40.00  
60.00  
80.00  
100.00  
120.00  
185.41

1042

K (b) SUPPLEMENTARY STATEMENT  
INTEREST ON OBLIGATIONS OF U. S. ISSUED AFTER SEPTEMBER 1, 1917  
(See Chapter XIII)

(a) PERIOD DURING WHICH HOLDINGS REMAINED UNCHANGED	(b) AMOUNT HELD INDIVIDUALLY	(c) EXCESS OVER EXEMPTION	(f) INTEREST DERIVED FROM (c)
(a) 2nd Liberty Loan Jan. 1 to May 15	\$10,000.00	None	None
May 15 to Dec. 31	10,000.00	None	None
(b) 3rd Liberty Loan May 15 to Dec. 31	40,000.00	\$15,000.00	\$223.50
Total taxable interest			<u>\$223.50</u>

# EXPLANATION

Since amount of bonds of Fourth Liberty Loan subscribed for and still owned at date of tax return is \$20,000, the exemption allowable on bonds of class (a) and (b) is  $1\frac{1}{2}$  times that amount or \$30,000, plus \$5,000, or \$35,000 in all. During the period January 1 to May 15 the holdings were \$10,000, which is less than the exemption of \$35,000. Therefore none of the interest received during that period is taxable.

During the period May 15 to December 31 the holdings of the Second Loan were \$10,000 and of the Third Loan \$40,000, or \$50,000 altogether, which exceeds the exemption of \$35,000.

The exemption for that period may be figured by either of two methods:

	FACE AMOUNT		SELECTED EXEMPTION	TAXABLE INTEREST		TAX-EXEMPT INTEREST
	OF BONDS					
<i>Case 1</i> 2nd Loan	\$10,000.00		None			
3rd Loan	40,000.00		\$35,000.00	\$200.00		
				74.50		\$521.50
				<u>\$274.50</u>		<u>\$521.50</u>
<i>Case 2</i> 2nd Loan	\$10,000.00		\$10,000.00			\$200.00
3rd Loan	40,000.00		25,000.00			
				\$223.50		372.50
				<u>\$223.50</u>		<u>\$572.50</u>
						\$200.00
						<u>223.50</u>

Total received during year, as per table 13.  
page 1.....

Since case 2 gives the larger amount of tax-exempt interest, that method is selected. Ordinarily, it could be taken for granted that interest on  $4\frac{1}{4}\%$  bonds would yield the larger exemption. The foregoing example is typical, however, of problems that arise in 1918, owing to the fact that the first interest instalment on the 3rd Liberty Loan was for a period less than 6 months.

\$996.00



MARRIED MAN—2 CHILDREN (UNDER 18 YEARS)—SUBJECT TO SURTAX, HAVING  $\frac{1}{2}$  INTEREST IN PARTNERSHIP  
 INCOME FROM STOCK DIVIDENDS TAXABLE AT 1913-1915, 1916, 1917, 1918 RATES  
 INCOME FROM PARTNERSHIP TAXABLE AT 1917-1918 RATES (FISCAL YEAR ENDING SEPTEMBER 30, 1918)

## SHOWING METHOD OF APPORTIONING TOTAL INCOME TO YEARS WITH DIFFERENT RATES

## FORM 1040

See Chapters XVI and XVII

ITEM

Partnership net income, reported for fiscal year (under 1917 law) .....	\$80,000.00
On which Excess Profits tax was paid of.....	\$12,000.00
Partnership receives refund of $\frac{3}{4}$ since Excess Profits tax applies only to 1917.....	9,000.00
	<u>\$ 3,000.00</u>
Partnership net income calculated under 1918 law (less because of more liberal provisions of 1918 law).....	\$72,000.00
Amount of 1917 income ( $\frac{1}{4}$ of fiscal year falling in 1917) $\frac{1}{4}$ of \$80,000 =.....	\$20,000.00
Less: Excess Profits tax applicable to 1917.....	3,000.00
	<u>\$17,000.00</u>
Partner's share ( $\frac{1}{2}$ ) taxable at 1917 rates.....	\$ 8,500.00
Amount of 1918 income ( $\frac{3}{4}$ of fiscal year falling in 1918) $\frac{3}{4}$ of \$72,000 =.....	\$54,000.00
Partner's share ( $\frac{1}{2}$ ) taxable at 1918 rates.....	<u>\$27,000.00</u>

14 (b) &amp; 30

ITEM		RECEIVED THROUGH PARTNERSHIP	
14 (a) & K (a)	Cash dividends .....		5,000.00
14 (a) & K (a)	Stock dividends at 1918 rates.....		6,000.00
14 - 6 & K (b)	Interest on Liberty Bonds (in excess of exemption).....		1,400.00
	Interest on "tax-free" bonds <sup>1</sup> .....		500.00
14 (b) 4	Stock dividends at 1917 rates.....	3,000.00	
		RECEIVED DIRECT	
12 (a)	Stock dividends at 1917 rates.....	8,000.00	
	Subject to surtax at 1918 rates.....		\$39,900.00
	Subject to surtax at 1917 rates.....		19,500.00
			\$59,400.00
	Stock dividends, subject to surtax at 1916 rates:		
12 (b)	Received direct .....	\$ 4,000.00	
14 (c)	Received through partnership .....	3,000.00	
			7,000.00
			\$66,400.00
	Stock dividends, subject to surtax at 1913-1915 rates:		
12 (c)	Received direct .....	\$ 2,000.00	
14 (d)	Received through partnership.....	2,500.00	
			4,500.00
			\$70,900.00

<sup>1</sup>This illustrates the practice that should prevail in 1919 after the enactment of the 1918 law, but does not hold for interest received by partnership in 1918.

# CALCULATION OF TAX

## NORMAL TAX AT 1918 RATES:

Share of partnership profits (plus \$500 interest on tax-free bonds) ..... \$27,500.00  
 Less: Personal exemption..... 2,400.00

33 Subject to tax at 6% (not over \$4,000)..... \$25,100.00  
 34 Subject to tax at 12% ..... 4,000.00  
 \$21,100.00  
 \$ 240.00  
 2,532.00

## NORMAL TAX AT 1917 RATES:

Share of partnership profits (at 4%)..... \$ 8,500.00

## SURTAX AT 1918 RATES:

36 \$5,000.00 exempt ..... Nil  
 133,000.00 at 1% to 14%..... \$ 3,050.00  
 1,900.00 at 18% ..... 342.00  
 \$39,900.00  
 3,392.00

## SURTAX AT 1917 RATES:

37 \$39,900 to \$40,000 \$ 100.00 at 8%..... \$ 8.00  
 40,000 to 59,400 19,400.00 at 12%..... 2,328.00  
 \$19,500.00  
 2,336.00

## SURTAX AT 1916 RATES:

\$59,400 to \$60,000 \$ 600.00 at 2%..... \$ 12.00  
 60,000 to 66,400 6,400.00 at 3%..... 192.00  
 \$7,000.00  
 204.00

## SURTAX AT 1915 RATES:

\$66,400 to \$70,900, \$4,500.00 at 2%..... 90.00

## TOTAL TAX

38 ..... \$9,134.00  
 39 Less: Tax paid at source (2% on "tax-free" bonds)<sup>1</sup>..... 10.00

41 Balance of tax due..... \$9,124.00

<sup>1</sup>This illustrates the practice that should prevail in 1919 after the enactment of the 1918 law, but does not hold for interest received by partnership in 1918.

Page 116

**Reconcilement of returns and books of account.**—A complete form for recording the reconcilement between books of account and income and excess profits tax returns is given on pages 1271 to 1273.

Page 117

**Fiscal year 1917-1918—Computation of tax.**—

**REGULATION.** Net losses deductible from net income of the fiscal year under the provisions of Section 204 of the statute shall be deducted in computing the tax attributable to the calendar year 1917, as well as in computing the tax attributable to the calendar year 1918. In computing the tax attributable to the calendar year 1917 the net income computed for the entire period under title I of the revenue act of 1916 as amended and title I of the revenue act of 1917 shall be credited with the excess profits tax computed for the entire period under title II of the revenue act of 1917. In computing the tax attributable to the calendar year 1918 the net income computed for the entire period under the present statute shall be credited with the war profits and excess profits taxes computed for the entire period under title III of the statute at the rates prescribed for 1918. See Section 236 of the statute. Amounts previously paid by the taxpayer on account of the income tax for such fiscal year shall be credited towards the payment of the income tax imposed for such fiscal year by the present statute. Any excess shall be credited or refunded in accordance with the provisions of Section 252 of the statute. (Reg. No. 45, Article 1623.) For illustration of the foregoing see Chapter XXII (supplement).

Page 129

**Payment of tax when fiscal year ended in 1918.**—

**REGULATION.** If a corporation has before February 25, 1919, filed a return for a fiscal year ending in 1918 and paid or become liable for a tax computed under the revenue act of 1917 and is subject to additional tax for the same period under the revenue act of 1918, the return covering such additional tax shall be filed at the same time as returns of persons making returns for the calendar year 1918 are due under existing rulings, and payment of such additional tax is due in the same instalments and at the same times as in the case of payments based on returns for the calendar year 1918. If no part of the tax for such fiscal year was due until after February 24, 1919, the whole amount of tax due, including tax due under the original return and additional tax due under the amended return, will be payable in the same instalments and at the same times as in the case of payments based on returns for the calendar year 1918. (T. D. 2797, March 11, 1919.)

Page 135

**Payments in certificates of indebtedness.**—T. D. 2778, December 11, 1918, provides that the certificates of indebtedness presented by the taxpayer must be in exact amount of the taxes to be paid by him. Article 1732, Reg. No. 45, modifies this and provides "any accrued interest to the date the tax is due . . . will be remitted to the taxpayer by the Federal Reserve bank by check, for which purpose the collector will furnish to the bank the name and address of the taxpayer, the amount and serial numbers of the certificates presented in each case, the date of the issue of the certificates and the date the tax is due."

Page 138

**Collection of tax.**—In view of the possibility that during the year 1919 certain taxpayers may be unable to pay the tax assessed upon them, it may be of interest to include the articles of the regulations dealing with the collection by process peculiar to the United States practice.

#### COLLECTION OF TAX BY DISTRAINT.—

**REGULATIONS.** If any person liable to pay any taxes neglects or refuses to pay them within ten days after notice and demand, it shall be lawful for the collector or his deputy to collect such taxes with 5 per cent additional and interest at 12 per cent per annum by distraint and sale of the goods, chattels or effects, including stocks, securities and evidences of debt, of the person delinquent. When goods, chattels or effects sufficient to satisfy the taxes imposed upon any person are not found by the collector or deputy collector, he is authorized to collect such taxes by seizure and sale of real estate. See further Sections 3186 (as amended by the act of March 4, 1913), 3187-3196, 3197 (as amended by the act of March 1, 1879), 3198-3202, 3203 (as amended by the act of March 1, 1879), 3204-3207, 3208 (as amended by the act of March 1, 1879) and 3209 of the revised statutes and Regulations No. 12 (revised). Distraint may also be used against a delinquent collector. See Section 3217 of the revised statutes. (Reg. No. 45, Article 1009.)

#### ENFORCEMENT OF TAX LIEN BY BILL IN EQUITY.—

In any case where there has been failure to pay the tax and it has become necessary to seize and sell real estate to satisfy it, a bill in equity may be filed in a district court of the United States to

enforce the lien of the United States for tax upon any real estate in which the delinquent has any right, title or interest. This remedy does not supersede distraint, but is cumulative. In the event of non-payment of a tax after demand it becomes a lien in favor of the United States from the time when the assessment list was received by the collector upon all property and rights to property belonging to the taxpayer, except that the lien is not valid as against any mortgagee, purchaser or judgment creditor until notice thereof is filed in the proper public office or offices on form 668. See Sections 3186 (as amended by the act of March 4, 1913) and 3207 of the revised statutes and Regulations No. 12 (revised). (Reg. No. 45, Article 1010.)

## CHAPTER V

### PROTESTS, APPEALS, OVERPAYMENTS, REFUNDS

Page 140

**Advisory tax board.**—On March 14, 1919, the Commissioner announced his appointments to the new Advisory Tax Board. The following is the official announcement:

Internal Revenue Commissioner Daniel C. Roper announced today his appointments to the new Advisory Tax Board of the Bureau of Internal Revenue. Five memberships are announced. The sixth membership has been reserved as a roving commission for experts who will be called in from time to time from various industries. The men named today are:

Dr. T. S. Adams, professor of political economy of Yale University, and formerly of the Wisconsin Tax Commission.

J. E. Sterrett, of New York, certified public accountant, and formerly president of the American Institute of Accountants.

Stuart W. Cramer, of Charlotte, N. C., engineer, contractor, and cotton manufacturer; former president of the National Association of American Cotton Manufacturers.

L. F. Speer, former deputy commissioner, Bureau of Internal Revenue, Income Tax Division.

Fred T. Field, of Boston, Mass., expert tax lawyer and formerly assistant attorney general of Massachusetts.

The chairman of the new board of advisers will be Dr. Adams, who has been active in the bureau's affairs for some time.

Particular attention will be given to problems arising where differences of opinion exist between the taxpayers and the bureau. Such

differences occur not only with individuals but also with groups and even with classes of industry.

Formal hearings will be given to taxpayers in every case where the facts warrant, and it was stated today at the Revenue Bureau that the smallest individual or the most eminent legal counsel for the largest corporation shall find a hearing equally accessible. Commissioner Roper has already announced his policy "to employ every means available so that the scales of justice may be held evenly in deciding each case."

The board will be called upon to decide questions involving the general aspects of taxation and differentiation of economic activities, accounting, forms of organization, trade customs, industrial management, legal procedure, and administration. Special studies will be made of such matters as they affect federal taxation.

It has been stated that so far as possible it is the desire of the Board to consider cases on the basis of papers submitted rather than on oral evidence. Heretofore the Board has been hearing cases upon the direct application of taxpayers but the intention in the future is to require that before a taxpayer is heard orally there shall have been submitted to the Audit Section all pertinent evidence, which in effect means that the Board will act as a Board of Appeals rather than one which exercises original jurisdiction.

Page 143

**Abatements and refunds.**—The following regulations set forth the details of procedure regarding claims for abatements and refunds. It will be noted that the claim for refund should be accompanied by the collector's receipt or by the canceled check showing payment of the tax.

**CLAIMS FOR ABATEMENT OF TAXES ERRONEOUSLY ASSESSED.**—

**REGULATIONS.** Claims by the taxpayer for the abatement of taxes or penalties erroneously or illegally assessed or abatable under remedial acts shall be made on form 47. They must be sustained by the affidavits of the parties against whom the taxes were assessed, or of other parties cognizant of the facts. When a tax has been assessed and turned over to the collector, the presumption is that the assessment is correct. The burden of proof in rebutting the presumption and showing that it was improperly or illegally assessed, or that relief

should be given under a remedial statute, rests upon the applicant for abatement. The affidavits must therefore contain full and explicit statements of all the material facts relating to the claim in support of which they are offered and to the proper consideration of which they are essential. The legality of the claim is to be determined by the Commissioner upon the facts presented by the affidavits. The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund. A collector may himself present once a month a blanket claim on form 47 for the abatement of taxes coming within certain classes of taxes erroneously assessed. (Reg. No. 45, Article 1032.)

#### CLAIMS FOR REFUND OF TAXES ERRONEOUSLY COLLECTED.—

Claims by the taxpayer for the refunding of taxes and penalties erroneously or illegally collected shall be made on form 46. In this case, as in that of claims for abatement, the burden of proof rests upon the claimant. All the facts relied upon in support of the claim should be clearly set forth under oath. It should be accompanied by the collector's receipt or the canceled check showing payment of the tax. In the case of a taxpayer's death, certified copies of the letters of administration or letters testamentary, or other similar evidence, should be annexed to the claim to show the authority of the administrator or executor. The affidavit may be made by an agent of the person assessed, but in such a case a power of attorney must accompany the claim. The lodging of a claim for refund made out in due form with the proper collector for the purpose of transmission to the Commissioner in the usual course of business is in legal effect a presentation of the appeal to the Commissioner. Warrants in payment of claims allowed will be drawn in the names of the persons entitled to the money and shall unless otherwise directed be sent by the Treasurer of the United States directly to the proper persons or their duly authorized attorneys or agents. In the case of mere overpayments by taxpayers the collector may repay the excess, subject to confirmation by the Commissioner of a claim for the refunding of such payments made by the collector on form 751 (revised). (Reg. No. 45, Article 1034.)



**TREASURY DEPARTMENT,  
U. S. INTERNAL REVENUE.  
Form 47.—Revised April, 1912.  
Ed. 200,000.**

## CLAIM FOR ABATEMENT

### TAXES ERRONEOUSLY OR ILLEGALLY ASSESSED

DATE OF FILING TO BE

State of \_\_\_\_\_ } ss:  
County of \_\_\_\_\_ }

**IMPORTANT**  
This claim should be forwarded to the Collector of Internal Revenue from whom notice of assessment was received.

**PLAINLY STAMPED HERE**

**Write Name  
so it can be  
easily read.**

(Name of claimant.)

(Address of claimant; give street and number as well as city or town, and State.)

'This deponent being duly sworn according to law, deposes and says that this claim is made on behalf of the claimant named above, and that the facts stated below with reference to said claim are true and complete:

1. Business engaged in by claimant \_\_\_\_\_
2. Character of assessment or tax \_\_\_\_\_
3. Amount of assessment \_\_\_\_\_ \$ \_\_\_\_\_
4. Amount now asked to be abated \_\_\_\_\_ \$ \_\_\_\_\_

Deponent verily believes that the amount stated in item 4 should be abated, and claimant now asks and demands abatement of said amount for the following reasons:

Sworn to and subscribed before me this

**Signed:**

\_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_

**Write Name**  
so it can be  
easily read.

(Title.)

(This affidavit may be sworn to before a Deputy Collector of Internal Revenue without charge.)

●

## CERTIFICATE OF ASSESSMENT

I certify that an examination of the records of the Commissioner's Office shows the following facts as to the assessment and payment of the tax:

[illegible]

*Assessment Clerk, Internal Revenue Bureau.*

**Form 47**

Abatement Order No. ....

District .....

-----  
(Nature of tax.)

**Claimant** \_\_\_\_\_

**Address** .....

*Examined and submitted for action* ..... , 19....

Claims examined by—  
 \_\_\_\_\_  
 Claims approved by—  
 \_\_\_\_\_  
*Chief of Division.*

**Amount claimed, \$**.....

**COMMITTEE ON CLAIMS:**

Amount allowed, \$.....

Amount rejected, \$.....

TREASURY DEPARTMENT,  
U. S. INTERNAL REVENUE,  
Form 44—Revised March, 1912.  
24, 125,000.

# CLAIM FOR REFUND.

## TAXES ERRONEOUSLY OR ILLEGALLY COLLECTED.

ALSO AMOUNTS PAID FOR STAMPS USED IN ERROR OR EXCESS.

Date of filing to be

State of \_\_\_\_\_  
County of \_\_\_\_\_

ss:

### IMPORTANT.

This claim should be forwarded to the Collector of Internal Revenue to whom the Tax was paid and must be accompanied by Collector's Receipt therefor.

plainly stamped here

Write Name  
so it can be  
easily read.

(Name of claimant.)

(Address of claimant; give street and number as well as city or town, and State.)

This deponent being duly sworn according to law deposes and says that this claim is made on behalf of the claimant named above, and that the facts stated below with reference to the claim are true and complete:

1. Business engaged in by claimant .....
2. Character of assessment or tax .....  
(Specify or upon what the tax was assessed or the stamps utilized.)
3. Amount of assessment or stamps ..... \$ .....
4. Amount now asked to be refunded (or such greater amount as is legally refundable) ..... \$ .....
5. Date of payment of assessment or purchase of stamps .....

Deponent verily believes that the amount stated in Item 4 should be refunded and claimant now asks and demands refund of said amount for the following reasons:

And this deponent further alleges that the said claimant is not indebted to the United States in any amount whatever, and that no claim has heretofore been presented, except as stated herein, for the refunding of the whole or any part of the amount stated in Item 3.

Sworn to and subscribed before me this .....

Signed:

day of ....., 19.....

Write Name  
so it can be  
easily read.

(Name.)

(Title.)

(This affidavit may be sworn to before a Deputy Collector of Internal Revenue without charge.)

7-225

### CERTIFICATES.

I certify that an examination of the records of the Commissioner's Office shows the following facts as to the assessment and payment of the tax:

NAME OF TAXPAYER.	Character of assessment and period covered.	List.	Year.	Month.	Page.	Line.	Amount.	Date paid.	District in which paid.
							\$		

Assessment Clerk, Internal Revenue Bureau.

I certify that the records of my office show the following facts as to the purchase of stamps:

TO WHOM SOLD OR ISSUED.	Kind.	Number.	Denomination.	Date of sale or issue.	Amount.	If special tax stamp, state:	
						Serial number.	Period commencing—
					\$		

Collector \_\_\_\_\_ District \_\_\_\_\_

Form 66.

Schedule Number .....

District .....

Allowed or Rejected Number .....

(Nature of tax.)

Claimant .....

Address .....

Examined and submitted for action ....., 19.....

COMMITTEE ON CLAIMS.

Claim examined by— /s/ _____
Claim approved by— _____
Chief of Division.

Amount claimed... \$ .....

Amount allowed... \$ .....

Amount rejected... \$ .....

9-2208

Page 145

**Five-year limitation.**—It has been stated that notwithstanding Section 250 (d), the government may at any time bring a common law action to recover, whenever by accident, mistake or fraud it has not received full payment of taxes. The 1918 law, however, limits the right of the government to an action unless a claim of fraud is sustained. If through accident or mistake the government has failed to collect any amount of income or excess profits tax due, it cannot bring an action to recover the same after five years have elapsed from the time the return was made.

Page 146

### **Refunds**

The following regulation sets forth the detailed procedure when a taxpayer makes claim for the refund of taxes or penalties erroneously collected by the government after suit has been brought.

#### **Claim for refund of sums recovered by suit.—**

**REGULATION.** (a) Claims by taxpayers for the amount of a judgment representing taxes or penalties erroneously collected should be made on form 46. The claimant should state the grounds of his claim under oath, giving the names of all the parties to the suit, the cause of action, the date of its commencement, the date of the judgment, the court in which it was recovered, and its amount. To this affidavit there should be annexed a certified copy of the final judgment, a certificate of probable cause, and an itemized bill of the costs paid received by the clerk or other proper officer of the court, together with a certified copy of the docket entries of the court in the case or so much thereof as may be required by the Commissioner. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the government,

no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury. See Section 989 of the revised statutes. (b) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name. There should also be a certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, with a detail of all items of costs which were paid by the judgment debtor or for which he is liable. (Reg. No. 45, Article 1036.)

Page 153

### **Understatements**

On page 153 the statement is made that care should be taken to produce evidence that no negligence was involved in the event that an understatement was made in a return. The following regulation is therefore of particular interest:

#### **Penalty for understated return.—**

REGULATION. (a) If an understatement of the amount of the tax in a return of income is due to negligence on the part of the taxpayer, but without intent to defraud, a penalty of 5 per cent of the amount of the deficiency is added; but (b) if the understatement of the tax is false with intent to evade the tax, a penalty of 50 per cent of the amount of the deficiency is added. (c) In case a false or fraudulent return is willfully made, other than as specified in (b) above, a penalty of 50 per cent of the amount of the tax is added. In general, negligence is attributable to the taxpayer if he computes the tax in disregard of the instructions on the return form or otherwise incorrectly, unless he can show that his error was due to an honest misunderstanding of the facts or the law of which an average reasonable man might be capable. (Reg. No. 45, Article 1005.)

It will be noted that if the mistake is one "of which an average man might be capable," the 5 per cent penalty will not be imposed. It is obvious that the penalty will not be assessed when arithmetical or other errors have been made, provided only they are such errors as the average man might make.

In view of the complexities and ambiguities of the law which are recognized by the Department itself, no reasonably careful person need fear this penalty. Of course, if a mistake is made which results in a very large understatement of the tax, the whole burden of proof will be placed upon the taxpayer to show that he was not on notice that a mistake had probably been made, because there are numerous methods of approximating the amount of tax due upon a given amount of net income.

## CHAPTER VI

### INFORMATION AT THE SOURCE

Page 162

**Information at the source.**—The following regulation regarding information which must be submitted by employers is of interest.

**REGULATION.** The names of all employees to whom payments exceeding \$1,000 a year are made, whether such total sum is made up of wages, salaries, commissions or compensation in any other form, must be reported. Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. In the case of an employer having a large number of employees who are moved from place to place as the exigencies of the service require, and who consequently has no complete record of annual payments to them at any one place, the salary of two representative months may be taken to establish a fair monthly wage, and unless the yearly payments based on this estimate in the case of an employee amounts to \$1,000 or more, no return of payments to such employee is required. When living quarters such as camps are furnished for the convenience of the employer, the ratable cost need not be added to the cash compensation of the employee in determining whether it equals \$1,000 annually. But where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished

constitutes income subject to tax, and a return of information is required in such case where the cash compensation received plus the value of living quarters furnished equals \$1,000 for the year. (Reg. No. 45, Article 1072.)

The law, Section 256, would seem to require that payments to corporations must be reported. Form 1099 (page 163) also can be interpreted the same way, but the regulations distinctly state that payments made to corporations and payments of rent made to real estate agents need not be reported.

**CASES WHERE NO RETURN OF INFORMATION IS REQUIRED.—**

**REGULATION.** Payments of the following character, although over \$1,000, need not be reported in returns of information on form 1099 (revised): (a) payments of interest on obligations of the United States; (b) dividends paid by domestic or resident corporations; (c) payments by a broker to his customers; (d) payments made to corporations; (e) bills paid for merchandise, telegrams, telephone, freight storage and similar charges; (f) payments to employees for board and lodging while traveling in the course of their employment; (g) annuities representing the return of capital; (h) payments of rent made to real estate agents (but the agent must report payments to the landlord if they amount to \$1,000 or more annually); (i) payments made by branches of business houses located in foreign countries to alien employees serving in foreign countries; and (j) payments made by the United States Government to sailors and soldiers not in excess of \$3,500. (Reg. No. 45, Article 1073.)

As stated elsewhere (page 1006), extensions of time for certain returns of income have been granted for a period not exceeding 90 days after the proclamation of peace. Article 444, which relates to enemies, provides "this extension, however, does not authorize any delay in filing returns of information."

Page 167

**Procedure in handling foreign items.—**It will be noted that substitute certificates are not provided for in Regulations No. 45, which are as follows:

**REGULATION.** In the case of collections of foreign items, regardless of amount, the original ownership certificates, when duly filed,



shall constitute and be treated as returns of information. (a) In the case of dividends, as to which the first bank or collecting agent is the source of information, it shall detach the ownership certificate and indorse on the item the words, "Certificate detached and information furnished," adding its name and address. When foreign items have been indorsed as above prescribed, the certificates shall be forwarded to the Commissioner (Sorting Division) on or before the 20th day of the month following that during which the items were accepted, accompanied by a letter of transmittal showing the number of certificates and the aggregate amount of foreign items disclosed thereon. (b) In the case of interest items, as to which the paying agent or the last bank or collecting agent in this country is the source of information, the ownership certificate shall accompany the coupon to such agent or source of information, who shall forward the ownership certificate to the Commissioner as above provided with respect to dividend items. Where ownership certificate form 1000 (revised) is used, a monthly return shall be made on form 1012 (revised) and an annual return on form 1013 (revised). The use of substitute certificates is not permitted in the collection of foreign items. (Reg. No. 45, Article 1078.)

Page 168

**Information as to actual owner.**—The specific penalties for failure or refusal to furnish information have been increased.

**SPECIFIC PENALTIES.**—

**REGULATION.** A penalty of not more than \$1,000 attaches for failure punctually to make a required return, whether of income, withholding or information, or to pay or collect a required tax. If the failure is willful, however, or an attempt is made to defeat or evade the tax, the offender is liable to imprisonment and to a fine of not more than \$10,000 and costs. See also the act of July 5, 1884. In addition to these specific penalties *ad valorem* penalties are imposed in various cases. An *ad valorem* penalty is assessed and collected as a part of the tax, while a specific penalty is recoverable only by suit. (Reg. No. 45, Article 1041.)

**Form 1060.**  
**Revised January 7, 1918.**  
**U. S. INTERNAL REVENUE.**  
**OWNERSHIP CERTIFICATE—TAX TO BE PAID AT SOURCE**  
**INTEREST ON BONDS OF DOMESTIC AND RESIDENT CORPORATIONS**  
**DEBTOR ORGANIZATION**  
**OWNER OF BONDS (Give name in full)**

Name \_\_\_\_\_  
 Address \_\_\_\_\_

**I CERTIFY that the owner of the bonds from which the interest entered herein was derived falls within the class of persons or organizations opposite which such interest is entered, and that exemption is not claimed from having the normal tax paid at the source on the amount of interest reported.**

Signature of owner or agent \_\_\_\_\_

Address of agent \_\_\_\_\_

If payee is an individual, is he married?	OWNER	INTEREST ON BONDS—		AMOUNT
		Citizen or Resident of United States: 1 Individual or fiduciary* Nonresident Alien: 2 Individual or fiduciary* 3 Corporation having no office or place of business in the United States Unknown: 4 †Coupons received not accompanied by ownership certificates (see note below)	Containing tax-free-covenant not claimed?	
		Containing tax-free-covenant not claimed?	\$	
		Whether or not containing tax-free-covenant clauses	\$	
		Whether or not containing tax-free-covenant clauses	\$	
		Whether or not containing tax-free-covenant clauses	\$	

\* Fiduciaries must enter under "Owner of Bonds" the name of estate, trust, or beneficiary on behalf of whom this certificate is made. Bonds are entered jointly, separate forms must be filed by each joint owner, and each owner must file a separate form if the name of the estate, trust, or beneficiary is unknown. If the name of the estate, trust, or beneficiary is unknown, the name of the owner of the bonds must be entered in the space provided for "Owner of Bonds," striking out the word "Owner" and inserting "Payee."

† This form must be used by debtor organizations to report payments of interest on registered bonds when such payments are not covered by ownership certificates made by owners of bonds. When so used, the form need not be signed, but must bear the name and address of the debtor organization.

62-7268

Form 1006.  
 Revised February, 1919.  
 U. S. INTERNAL REVENUE.

**OWNERSHIP CERTIFICATE—TAX NOT TO BE PAID AT SOURCE**  
 INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND RESIDENT CORPORATIONS  
 AND OF FOREIGN CORPORATIONS HAVING A PAYING AGENT IN THE UNITED STATES

DEBTOR ORGANIZATION

OWNER OF BONDS (Give name in full)

NAMES MUST BE PRINTED  
 OR WRITTEN PLAINLY.

NAME \_\_\_\_\_

STREET ADDRESS \_\_\_\_\_

POST OFFICE		INTEREST ON BONDS AND SIMILAR OBLIGATIONS	
OWNER		With tax-free-cessant clauses	Without tax-free-cessant clauses
Citizen or Resident of U. S.:			
1. Individual or fiduciary (Personal exemption claimed)*		\$	\$
2. Individual or fiduciary (Not subject to withholding)		\$	\$
3. Partnership		\$	\$
4. Corporation		\$	\$
Nonresident Alien:			
5. Partnership		\$	\$
6. Corporation having an office or place of business in U. S.		\$	\$

\* The exemption claimed during a taxable year by ownership certificate must not exceed the personal exemption allowed by law. If personal exemption is claimed, the certificate must not be received, credit for tax paid at source must not be claimed with respect to such interest on the taxpayer's individual income tax return.

Due date \_\_\_\_\_ Date paid \_\_\_\_\_

If owner is an individual, is he married? \_\_\_\_\_ If not, is he head of a family? \_\_\_\_\_

I certify that the owner of the bonds or other similar obligations from which the interest entered herein was derived falls within the class of persons or organizations opposite which the amount of such interest is entered and is entitled to such interest without deduction of tax.

SIGNATURE OF OWNER  
 OR AGENT \_\_\_\_\_

Address of agent \_\_\_\_\_

SEE INSTRUCTIONS ON FORM 1006 A

U. S. INTERNAL REVENUE  
Form 1001—A (Revised October, 1918)

FOREIGN ITEMS

OWNERSHIP CERTIFICATE—TAX NOT TO BE PAID AT THE SOURCE

(For the use of citizen or resident owners of stock of all foreign corporations, and citizen or resident owners of bonds of foreign countries or foreign corporations.  
For exceptions, where bond contains tax-free covenant, see Art. 35, Par. 4, of Regulations, No. 33, Revised, as amended by Treasury Decision 2759.)

DEBTOR ORGANIZATION

OWNER OF BONDS OR STOCKS

NAMES MUST BE PRINTED  
OR WRITTEN PLAINLY

Name \_\_\_\_\_ Address \_\_\_\_\_  
Name \_\_\_\_\_ Address \_\_\_\_\_

(On line above give full description of foreign item, date of dividend, or maturity of interest.)

I CERTIFY that the owner of the bonds or stock upon which the above-described income accrued falls within the class of persons or organizations opposite which such income is entered, and is entitled to receive the income reported without deduction of tax.  
(Signature of owner or agent.)

Address of agent { \_\_\_\_\_  
\_\_\_\_\_

NOTE.—The first licensed bank or collecting agent receiving this certificate is required to detach and forward it to the Commissioner of Internal Revenue (Sorting Division), Washington, D. C., accompanied by a letter of transmittal showing the number of certificates and the aggregate amount of foreign items disclosed thereon; except that in the case of interest on bonds, the coupon accompanied by the proper ownership certificate shall be forwarded to the paying agent in this country, if one has been appointed, and in cases where there is no such agent the coupon to the last bank or collecting agent handling the item in this country. The certificate shall be delivered to the paying agent or to the Commissioner of Internal Revenue, as the case may be, in the same manner as prescribed in the case of the first licensed bank or collecting agent in the source. When the certificate is detached by the first licensed bank or collecting agent such bank or agent shall

If the owner is an individual, is he married? -----		If not, is he the head of a family? -----	
OWNER.		INTEREST.	
1. Citizen or resident of the United States, individual or fiduciary*	\$ _____	\$ _____	\$ _____
2. Domestic or resident corporation, association, or partnership	\$ _____	\$ _____	\$ _____

\*Fiduciaries must enter under "Owner of bonds or stocks" the name of estate, trust, or beneficiary on behalf of whom this certificate is made.  
If securities are owned jointly by several persons, one may sign, and the names, addresses, and proportion of ownership of each indorsed on the back hereof.

Indorse upon the foreign item, "Certificate detached and information furnished ( \_\_\_\_\_ )"  
(Name and address of licensee.)

Date \_\_\_\_\_

3-603

**Substitute Certificate—tax to be paid at source.**

(To be attached to interest coupons when collecting agent's certificate is substituted for certificate of owner, a citizen or resident of the United States, in which exemption was not claimed.)

No. \_\_\_\_\_

(Give name of debtor.)

(Full post-office address of debtor.)

191

Amount of coupon or registered interest, \$ \_\_\_\_\_

(Date of maturity of interest.)

I (we) do solemnly declare that the owner of the bonds from which were detached the accompanying coupons has filed with me (us) a certificate of ownership, Form No. 1000, duly executed and filled in according to Treasury Regulations, which certificate has been indorsed by me (us) as required by Treasury Regulations, and which certificate did not claim any exemption from having the normal tax of 2 per cent withheld by the debtor at the source; and I (we) do hereby promise and pledge myself (ourselves) to forward the said certificate to the Commissioner of Internal Revenue at Washington, D. C., not later than the 20th day of next month, in accordance with Treasury Regulations.

Date, \_\_\_\_\_, 191

(Name of bank or collecting agency.)

By \_\_\_\_\_  
(Signature of person authorized to sign, and his official position.)

(Full post-office address of collecting agency.)

2-7608

THIS CERTIFICATE HAS NO EFFECT ON CITIZENSHIP.

CERTIFICATE OF ALIEN CLAIMING RESIDENCE IN THE UNITED STATES.

(To be filed with withholding agent by alien residing in the United States for the purpose of claiming the benefit of such residence for income tax purposes.)

I hereby declare that I am a citizen or subject of .....; that I arrived in the United States on or about .....; that I am living in the United States and have no definite intention as to when (if at all) I will make another country my home; that the address in the United States where any notices relative to income tax may be sent or mailed to me is .....

(Street and Number)

(City)

(State)

Sworn to and subscribed before me this

(Signed)

day of ....., 191

(Official Capacity.)

FORM 1099—REVISED FEBRUARY, 1919—UNITED STATES INTERNAL REVENUE SERVICE

# ANNUAL INFORMATION RETURN

OF

PAYMENTS OF INTEREST, SALARIES, RENT, ETC., OF \$1,000 OR MORE

For Calendar Year 1918

<p><b>THIS RETURN, ACCOMPANIED BY REPORTS ON FORM 1099, MUST BE MAILED TO THE COMMISSIONER OF INTERNAL REVENUE, SORTING DIVISION, WASHINGTON, D. C., ON OR BEFORE MARCH 15, 1919.</b></p>	<p>(Name of person or organization by whom payments were made)</p> <hr/> <p>(Street and number or rural route)</p> <hr/> <p>(Post office) (State)</p>	<p>(Date received)</p>						
<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 60%;">CLASSES OF INCOME</th> <th style="width: 20%;">NUMBER OF REPORTS ON FORM 1099</th> <th style="width: 20%;">TOTAL AMOUNT OF PAYMENTS</th> </tr> </thead> <tbody> <tr> <td>Interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income of \$1,000 or more</td> <td style="text-align: center;">\$</td> <td></td> </tr> </tbody> </table>			CLASSES OF INCOME	NUMBER OF REPORTS ON FORM 1099	TOTAL AMOUNT OF PAYMENTS	Interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income of \$1,000 or more	\$	
CLASSES OF INCOME	NUMBER OF REPORTS ON FORM 1099	TOTAL AMOUNT OF PAYMENTS						
Interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income of \$1,000 or more	\$							

## INSTRUCTIONS

Every individual or organization, in whatever capacity acting, who made payments of income as described above during the calendar year 1918 to any individual citizen or resident of the United States, or domestic partnership, is required to render a return on this form on or before March 15, 1919.

The return should be accompanied by reports on Form 1099, showing the name and business address of the person or organization by whom the payments were made, the full name and address of each individual or partnership to whom the payments were made, the kind of income paid, and the amount.

Partnerships and personal service corporations should prepare reports on Form 1099 for each member of the partnership or personal service corporation. Fiduciaries should make these reports for each beneficiary of the estate or trust. In these cases the word "partnership," "personal service corporation," or "fiduciary" should be entered on the blank line on Form 1099. Income tax returns of partnerships, personal service corporations, and fiduciaries accompanied by reports on Form 1099 should be filed with the Collector of Internal Revenue on or before March 15, 1919.

Reports on Form 1099 are not required in the following cases:

1. Interest on the obligations of the United States, of States, Territories, or political subdivisions thereof or of the District of Columbia and compensation paid officers and employees by a State or political subdivision thereof for personal services.

2. Dividends paid by domestic or resident corporations (not including earnings of personal service corporations).

3. Payments by brokers to their customers.

4. Bills paid for merchandise, telegrams, telephone, freight, storage, and similar charges.

5. Amounts paid to employees for expenses incurred in business.

6. Premiums paid to insurance companies.

7. Annuities representing return of capital.

8. Interest accrued on bank deposits if not credited.

9. Rent paid to real estate agents (but the agent must report payments of rent made to the landlord if they amount in the aggregate to \$1,000 or more for the year).

10. Payments made by domestic establishments or foreign branch houses thereof to nonresident alien employees for services performed entirely in foreign countries.

11. Salary or compensation of \$3,500 or less paid for active services to persons in the military or naval forces of the United States.

12. Interest on bonds of domestic and foreign corporations. (See Forms 1012 and 1096A.)

13. Salaries, wages, etc., paid to nonresident alien individuals and foreign corporations. (See Form 1042.)

The name and address of the individual or organization making reports on Form 1099 may be printed or stamped on each form, but the return Form 1099 must be made under oath.

I swear (or affirm) that to the best of my knowledge and belief the foregoing return and the accompanying reports constitute a true and complete statement of payments of the above-described classes of income made by the person or organization named at the head of this return during the calendar year 1918.

Sworn to and subscribed before me this \_\_\_\_\_ day

(Signature.)

of \_\_\_\_\_, 19\_\_\_\_

(Signature.)

(State whether individual owner, member of firm, or disbursing officer of Government bureau or office, or if officer of corporation give title.)

(Title.)

(State address of person signing if different from that given at head of return.)

Form 1096A—UNITED STATES INTERNAL REVENUE SERVICE

**MONTHLY INFORMATION RETURN****PAYMENTS OF INTEREST ON BONDS OF DOMESTIC AND FOREIGN CORPORATIONS AND COUNTRIES AND DIVIDENDS ON STOCK OF FOREIGN CORPORATIONS****FOR MONTH OF \_\_\_\_\_, 1919**

THIS RETURN,  
ACCOMPANIED BY  
CERTIFICATES ON FORM  
1001 AND 1001A,  
MUST BE MAILED TO  
THE COMMISSIONER OF  
INTERNAL REVENUE,  
SORTING DIVISION,  
WASHINGTON, D. C.,  
ON OR BEFORE THE  
2ND DAY OF THE MONTH  
SUCCEEDING THAT  
FOR WHICH MADE

(Date received)

(Name of debtor organization)

(Full post-office address)

(Name of bank or paying agent)

(Full post-office address)

CLASS OF INCOME	NUMBER OF CERTIFICATES	TOTAL AMOUNT OF PAYMENTS		
	(FORM 1001)			
A. Interest on bonds and other similar obligations of domestic and resident corporations (provided tax was not withheld at source).....		\$		
	(FORM 1001A)			
B. Interest on bonds of foreign corporations and countries and dividends on stock of foreign corporations.....		\$		

**INSTRUCTIONS**

- A. A certificate on Form 1001 should accompany this return for every payment of interest on bonds and other similar obligations of domestic and resident corporations, under the following conditions:
- Interest on bonds with tax-free-covenant clauses paid to citizens and residents of the United States (individuals and fiduciaries) claiming personal exemption, domestic and resident corporations, and foreign corporations having an office or place of business in the United States.  
In the absence of ownership certificates made by individual owners of tax-free registered bonds the debtor organization shall prepare reports on Form 1000 and forward them to the collector with return Form 1012. If owned by a domestic corporation, or foreign corporation having an office or place of business in the United States, reports on Form 1001 should be prepared. When so used the forms need not be signed.
  - Interest on bonds without tax-free-covenant clauses paid to citizens and residents of the United States (individuals and fiduciaries), domestic and resident partnerships and corporations, nonresident alien partnerships, and foreign corporations having an office or place of business in the United States.  
In the case of registered bonds not having tax-free-covenant clauses the debtor organization will prepare reports on Form 1001 and forward them with this return to the Commissioner. When so used the form (1001) need not be signed.  
Resident collecting agents, responsible banks and bankers receiving interest coupons presented by individual citizens or residents of the United States for collection, may detach Certificate Form 1001 and forward it directly to the Commissioner of Internal Revenue, provided Certificate Form 1058 (revised) is substituted for the certificate detached. Substitute certificates, Form 1058, should be included by the debtor corporation on line A, in the column "Number of Certificates."
- B. A certificate on Form 1001A should be required by individuals, partnerships, and corporations undertaking as a matter of business or for profit the collection of interest on bonds of foreign corporations and countries and dividends on stock of foreign corporations by means of coupons, checks, or bills of exchange for citizens and residents of the United States (individuals and fiduciaries), domestic and resident partnerships and corporations, and nonresident alien individuals, partnerships, and corporations.
- If the payments consist of interest on bonds (and there is no paying agent in the United States), the last bank or collecting agent handling the item shall detach the certificate, Form 1001A, and forward it directly to the Commissioner of Internal Revenue, accompanied by a return on this form.
- If the payments consist of dividends on stock of foreign corporations, the first bank or collecting agent receiving the certificate (Form 1001A) is required to detach and forward it directly to the Commissioner of Internal Revenue. The first bank shall indorse upon the return item "Certificate detached and information furnished (insert name and address of licensee)." Substitute certificates are not permitted to be used in the case of foreign items.
- If bonds are owned jointly, separate certificates should be made by or for each joint owner. Fiduciaries must enter on the certificates under "Owner of bonds" the name of estate, trust, or beneficiary on behalf of whom the exemption is claimed. Licensed banks and collecting agents not acting as withholding or paying agents for debtor organizations may file one return on this form, making no entries in the spaces at the head of the form for name and address of debtor organization.

I CERTIFY that the foregoing return and the accompanying certificates constitute a true and complete statement of payments of the above-described classes of income made by the person or organization named at the head of this return, during the month stated above.

Dated \_\_\_\_\_

(Signature)

(Capacity in which acting)

2-8000

(Address in full)



# REPORT OF INCOME OF \$1,000 OR MORE PAID DURING THE CALENDAR YEAR 1918

SAALARIES, WAGES, RENT, INTEREST, OR OTHER FIXED OR DETERMINABLE GAINS,  
PROFITS, AND INCOME

BY WHOM PAID

TO WHOM PAID

NAME _____	NAME _____
ADDRESS _____	ADDRESS _____
	(Street and number or rural route)
	(Post office and State)

INSTRUCTIONS	If payee is an individual, is he married? _____		If not, is he head of a family? _____	
	KIND OF INCOME PAID		AMOUNT	
<p>One of these forms must be filled in for each person to whom income, as described on this form, was paid during the calendar year 1918. The name and business address of the person or organization making the payments should be entered under the heading "By whom paid" and the name and home address (if an individual) or business address (if an organization) of the one to whom the income was paid should be entered under the heading "To whom paid."</p> <p>These forms must be forwarded with return Form 1098 to the Commissioner of Internal Revenue, Sorting Division, Washington, D. C., on or before March 15, 1919.</p> <p>Do not report on this form dividends on stock, interest on bonds of domestic or foreign corporations, or interest on bonds and other obligations of the United States or foreign countries. For further instructions see Form 1096.</p>	Salaries, wages, fees, commissions, etc.	\$		
	Rent	\$		
	Interest on notes, mortgages, etc.	\$		
	Premiums and annuities	\$		

On the blank line above enter the kind and amount of any other fixed or determinable gains, profits, and income except as noted in instructions.

62-5873

Form 1122—UNITED STATES INTERNAL REVENUE SERVICE.

**INFORMATION RETURN OF SUBSIDIARY OR AFFILIATED CORPORATION****WHOSE NET INCOME AND INVESTED CAPITAL ARE INCLUDED IN RETURN OF A PARENT OR PRINCIPAL REPORTING CORPORATION FOR PURPOSES OF INCOME AND PROFITS TAXES****FOR CALENDAR YEAR 1918**

OR

(Date Received)

**This Return  
Must Be Filed  
On or Before  
March 15, 1919  
With the Collector  
of Internal Revenue  
For the District in  
Which the Subsidiary  
or Affiliated Corpora-  
tion has its Principal  
Office.**

Fiscal period begun ..... and ended ....., 1918

Name .....

Business address .....

(Street and number.)

(City or town.)

(State.)

1. Date incorporated ..... Under laws of what State? .....
2. Kind of business .....
3. Par value of capital stock outstanding at beginning of taxable year: (a) common, \$.....  
(b) preferred, \$.....
4. Par value of capital stock held during the taxable year by (a) the parent corporation or (b) the same interest:

PERIODS IN THE TAXABLE YEAR DURING WHICH THE STOCK HELD REMAINED UNCHANGED.		PAR VALUE OF STOCK.		PERIODS IN THE TAXABLE YEAR DURING WHICH THE STOCK HELD REMAINED UNCHANGED.		PAR VALUE OF STOCK.	
FROM—	TO—	COMMON.	PREFERRED.	FROM—	TO—	COMMON.	PREFERRED.
.....	.....	\$.....	\$.....	.....	.....	\$.....	\$.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....
.....	.....	.....	.....	.....	.....	.....	.....

NOTE.—All stock should be designated as voting ("v.") or nonvoting ("n. v.").

5. Name of parent corporation .....
6. Address of parent corporation .....
7. Internal revenue district in which consolidated return has been filed .....  
(Give district, or city and State.)
8. If affiliation occurs through ownership of stock by the same interests, attach to this form a list showing the names and addresses of stockholders and amount and description of stock held by each.
9. State amount of income and profits taxes for the taxable year apportioned to the subsidiary or affiliated corporation making this return ..... \$.....

We, the undersigned, president and treasurer of the above-named subsidiary or affiliated corporation, being severally duly sworn, each for himself deposes and says that the foregoing return, including the accompanying list (if any), has been examined by him and is to the best of his knowledge and belief a true and complete return of information made in good faith pursuant to the Revenue Act of 1918 and the regulations thereunder.

SWORN to and subscribed before me this

..... day of ....., 19.....

(Name of officer.)

President.

(Title.)

Treasurer.

**Forms of ownership certificates.**—The table on page 171 states that form 1001 is to be used by domestic partnerships in connection with tax-free bonds. The regulations provide that domestic partnerships shall use form 1000 when no personal exemption or credit is claimed against interest on such bonds, in which case form 1001 would be used.

The regulations provide that form 1001A revised must be used for foreign items. The regulations also provide that in certain cases form 1000 revised shall be used. In the table on page 171 the statement is made that form 1071 be used for non-resident alien individuals, foreign partnerships and foreign corporations, having no office or place of business in the United States. It would appear that form 1071 has been eliminated and therefore non-resident aliens should use the forms prescribed for citizens or residents of the United States.

#### OWNERSHIP CERTIFICATES FOR FOREIGN ITEMS.—

**REGULATIONS.** Where bonds of foreign countries, or bonds or stocks of non-resident foreign corporations, are owned by citizens or residents of the United States, individual or fiduciary, or by domestic or resident corporations or partnerships, or by non-resident alien individuals, corporations or partnerships, ownership certificate 1001 A (revised) shall be executed by the actual owner or by his duly authorized agent when presenting the item for collection, whether such item is a dividend or an interest payment, except in the case of a foreign country or a foreign corporation having a paying agent in this country and issuing bonds which contain a tax-free covenant clause. In such a case the paying agent is required to withhold the normal tax upon the interest on such bonds, and ownership certificate form 1000 (revised) should be used, unless the owner (if so entitled) desires to claim exemption, in which case form 1001 A (revised) should be filed. (Reg. No. 45, Article 1077.)

## CHAPTER VII

## PAYMENT OF TAX AT SOURCE

Page 176

**Release of excess taxes withheld.**—Regulations No. 45 cover the procedure in connection with the release by withholding agents of excess amounts withheld.

**REGULATION.** Any sum withheld for tax since December 31, 1917, in excess of the amount prescribed by the revenue act of 1918, shall be released by the withholding agent and paid over to the person from whom it was withheld or his proper representative. With reference to how a debtor corporation may release and pay over the amount of tax so withheld in a case where a bank or other collection agency detached the ownership certificate which accompanied an interest coupon and substituted its own certificate (form 1059), which does not disclose the name and address of the bond owner, in such cases the withholding agent shall request the bank or collection agency to disclose the name and address of the owner of the bonds, as shown by the original certificate, and it shall be the duty of the bank or collection agency to make such disclosure to the withholding agent. Where withholding agents have so released any excess of tax, an itemized statement showing the names, addresses and amounts refunded should be attached to the annual list returns (form 1013), in order to reconcile any discrepancy between the aggregate amount of taxes returned as shown by the monthly list returns (form 1012) and the aggregate amount as shown by the annual list return. (Reg. No. 45, Article 369.)

Page 177

**Exemption from withholding.**—Article 362, Reg. No. 45, suggests that the resident alien should file form 1078 with coupons as well as the usual certificate.

Article 601 requires foreign corporations having an office or place of business in the United States to file certificates stating that fact in addition to the usual ownership certificate.

**REGULATIONS.** Withholding from interest on bonds or other obligations containing a tax-free covenant shall not be required in the

case of a citizen or resident alien individual if he files with the withholding agent when presenting interest coupons for payment, or not later than February first following the taxable year, an ownership certificate on form 1001 (revised) claiming a personal exemption or credit for dependents. To avoid inconvenience a resident alien individual should file a certificate of residence on form 1078 (revised) with withholding agents, who shall forward such certificates to the Commissioner (Sorting Division) with a letter of transmittal. Notwithstanding the provisions of Section 217 of the statute, withholding is required from income of a non-resident individual. No withholding from corporate dividends is required in any case. The income of domestic and resident foreign corporations is free from withholding. (Reg. No. 45, Article 362.)

#### WITHHOLDING IN THE CASE OF NON-RESIDENT FOREIGN CORPORATIONS.—

With respect to payments to foreign corporations not engaged in trade or business within the United States and not having any office or place of business therein, withholding is required of a tax of 2 per cent in the case of interest payable upon corporate bonds or other obligations containing a tax-free covenant clause, and of a tax of 10 per cent in the case of other fixed or determinable annual or periodical income, other than corporate dividends. To enable debtors in the United States to distinguish between foreign corporations which have and those which have not any office or place of business in the United States, and also to enable such corporations as have an office or place of business in the United States to claim exemption from withholding the tax on bond interest or other income, a certificate stating that any such corporation has an office or place of business in the United States should be filed by it with the debtor. (Reg. No. 45, Article 601.)

Page 178

**Payment of tax withheld at the source.**—The following extract from the *Income Tax Primer*, 1919, sets forth the procedure regarding the return and payment of tax withheld at the source. It will be noted that there is no provision for making payment in instalments and it will also be noted that the time for filing withholding returns has been extended to May 15, 1919.

**RULING.** How is tax withheld at the source to be returned and paid?

Tax withheld from income other than interest on corporate obligations shall be reported to the collector of internal revenue for your district on income tax form 1042 revised, accompanied by certificate 1098 revised, covering each item in the return, on or before March 1 of the year next succeeding the year during which the withholding occurred. Tax withheld from interest on corporate obligations shall be reported to the collector on form 1012 revised, within 20 days after the close of the month during which the withholding occurred, and summary of such monthly returns shall be made to the collector on or before March 1 on form 1013 revised.

Payment of the amount of tax assessed against a withholding return shall be made to the collector of internal revenue in whose district the withholding agent is located. Such payment is to be made on or before June 15 of the year in which the withholding return is required to be filed.

The time for filing withholding returns for 1918 has been extended by Treasury Decision 2796 to May 15, 1919. (*Income Tax Primer*, 1919, question 120.)

**INTEREST ON BONDS AND OTHER SIMILAR OBLIGATIONS OF DOMESTIC AND  
RESIDENT CORPORATIONS AND FOREIGN CORPORATIONS HAVING  
A PAYING AGENT IN THE UNITED STATES**

THIS RETURN, IN DUPLICATE, ACCOMPANIED BY CERTIFICATES ON FORM 1000 MUST BE FILED WITH THE COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT IN WHICH THE WITHHOLDING AGENT IS LOCATED ON OR BEFORE THE 2ND DAY OF THE MONTH SUCCEEDING THAT FOR WHICH MADE

(Name of donor organization.)
(Full post-office address.)
(Name of withholding agent.)
(Full post-office address.)

## INSTRUCTIONS

I certify that the following is a true and complete return of all payments of classes 1, 2(a), and 2(b) described above made, and of the amount of tax withheld during the month stated above by the above-named organization, the several items being evidenced by certificates listed below and inclosed herewith:

CLASS	INTEREST PAID		TAX WITHHELD	
1	\$		\$	
2(a)				
2(b)				
TOTALS	\$		\$	

(Signature.)

(Capacity in which acting.)

(Address in full.)

[illegible]

## CHAPTER VIII

## INCOME IN GENERAL

Page 191

**Methods of accounting.**—On page 191 *et seq.*, will be found comments on the various provisions of the 1918 law, the purport of which is to assemble within a certain taxable period all of the taxpayer's income and deductions for such period, whether received, paid, accrued or incurred. The following regulations set forth in greater detail the policy of the Department.

## BASES OF COMPUTATION.—

**REGULATIONS.** Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See Section 200 of the statute for definitions of "paid," "paid or accrued," and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. See Section 213 of the statute. A taxpayer is deemed to have received items of gross income which have been credited or made available to him without restriction. On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through conversion of the property. (Reg. No. 45, Article 23.)

Page 191

## ACCOUNTING PERIOD.—

The return of a taxpayer is made and his income computed for his "taxable year" which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were



kept in accordance therewith. The taxable year 1918 is the calendar year 1918, or any fiscal year ending during the calendar year 1918. A taxpayer shall make his return for the taxable year 1918 on the basis of his annual accounting period (fiscal or calendar year), even though a part of such accounting period was included in a period for which he had previously made return. Thus an individual whose accounting period ended June 30, 1918, and who had previously made a return for the calendar year 1917, should make a complete return in accordance with the provisions of the statute for the twelve months ending June 30, 1918. . . . A taxpayer making his first return for income tax shall make such return on the basis of his annual accounting period. Except in the cases of a return for the taxable year 1918 and of a first return for income tax, a taxpayer shall make his return on the basis (fiscal or calendar year) upon which he made his return for the taxable year immediately preceding unless, with the approval of the Commissioner, he has changed the basis of computing his net income. (Reg. No. 45, Article 25.)

#### TIME FOR DEDUCTION OF CHARGES.—

Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities or deficit of one year cannot be used to reduce the income of a subsequent year. A person making returns on an accrued basis has the right to deduct all authorized allowances, whether paid in cash or set up as a liability, and it follows that if he does not within any year pay or accrue certain of his expenses, interest, taxes or other charges, and makes no deduction therefor, he cannot deduct from the income of the next or any subsequent year any amounts then paid in liquidation of the previous year's liabilities. A loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence. Any amount paid pursuant to a judgment or otherwise on account of damages for personal injuries, patent infringement or otherwise is deductible from gross income when the claim is liquidated or put in judgment or actually paid, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequently thereto, however, a taxpayer has for the first time ascertained the amount of a loss sustained during a prior taxable year and not deducted from the gross income therefor, he may render an amended return for such preceding taxable year, including such amount of loss in the deductions from gross income, and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. See Section 252 of the statute and Articles 1031-1036. (Reg. No. 45, Article 111.)

CHANGING FROM CASH TO ACCRUAL METHOD.—The attitude of the Department regarding the acceptance of amended returns in case taxpayers desire to change from cash to an accrual basis, is well indicated by the following ruling:

RULING. Receipt is acknowledged of your letter of February 8, 1919, in which you state:

"On January 1, 1918, we changed our method of handling discount and interest on time loans. Up to this time all discount and interest charged on loans had been credited directly to discount and interest, but at this date the actual amount of discount and interest, which had been so credited and was still unearned, was ascertained, credited to unearned account on our books, and thereafter all discount and interest collected in advance was credited to this account, our discount earned receiving credit for each day's actual earnings."

You ask to be advised what course you should pursue in the preparation of your income and war excess profits tax returns for the year 1918. The method of treating discount and interest on time loans adopted by you on January 1, 1918, has been generally recognized as the correct method of computing such income, and the Comptroller of the Currency has suggested the adoption of this method by all national banks. The amount of income from discount and interest on time loans which you should report for the year 1918 is the amount of such income actually earned during that year, and as the amount of such income for the year 1917 and years prior thereto has been computed and reported upon a different method, amended returns should be filed showing the correct amount of such income for each year back to 1909, inclusive, or to the date of the organization of your bank, if it was organized subsequent to 1909. (Letter to a National Bank, signed by Commissioner Daniel C. Roper, and dated February 11, 1919.)

All that is required is reasonably accurate amended returns. A close estimate can be made without very much labor, and will serve quite as well as if a recomputation were made of every item which affected more than one taxable year.

## CHAPTER IX

## INCOME FROM PERSONAL SERVICES

Page 203

**Income received and later refunded.**—During 1918 there were certain cases where compensation received by employees during the previous year was held by the Alien Property Custodian to have been excessive and such employees were required to return the amounts alleged to have been excessive. The employees had reported the compensation in 1917 and had paid the tax thereon. In such cases the proper procedure would be for the employees to file amended returns for 1917 and set forth the facts of the case which would indicate that an excessive amount of income had been returned and that a refund was in order.

Page 208

**Share of taxes payable by employee.**—On page 210 reference is made to a formula for determining the tax to be paid when the compensation of an employee who has an interest in the profits is a taxable expense. The following illustrations contain as simple a method as can be devised for arriving at the desired result.

# PROBLEM

The manager of a corporation is to receive 10 per cent of the net income after taxes. As the amount to be paid the manager is a proper deduction in calculating the taxes, it becomes necessary to ascertain a sum which when used as a deduction in calculating the taxes will be 10 per cent of the amount remaining for both himself and the corporation after taxes are paid by the corporation.

The following calculation is set forth in a way which will enable anyone with only an elementary knowledge of algebra to understand the solution of the problem.

Assuming the invested capital of the corporation in 1918 to be \$500,000, the income for 1918 \$150,000, and the average pre-war earnings less than 10 per cent of the present invested capital, what is the manager's bonus?

Let  $x$  = manager's bonus

## WAR EXCESS PROFITS TAX:

Income .....	\$150,000 — $x$
Exemption:	
10% of Invested Capital.....	\$50,000
And .....	3,000
	<u>53,000</u>
	<u>\$97,000 — <math>x</math></u>

Tax at 80%..... \$77,600 —  $4/5 x$

## INCOME TAX:

Income .....	\$150,000 — $x$
Exemption:	
War Excess Profits Tax.....	\$77,600 — $4/5 x$
And .....	2,000
	<u>— 79,600 + <math>4/5 x</math></u>
	<u>\$70,400 — <math>1/5 x</math></u>

Tax at 12%.....

8,448 —  $\frac{12}{500} x$

Total Taxes .....

\$86,048 —  $\frac{412}{500} x$

Income .....	\$150,000 — x
Taxes .....	$86,048 + \frac{412}{500}x$
	<hr/>
Net Income to Corporation.....	$\frac{88}{500}x$
	<hr/>
	$\$63,952 - \frac{88}{500}x$
	<hr/>

As the manager is to receive 10 per cent of profits leaving 90 per cent for the corporation, his share is  $\frac{1}{9}$  of the net income of the corporation, hence:

$$9x = \$63,952 - \frac{88}{500}x$$

$$9\frac{88}{500}x = 63,952$$

$$4,588x = 31,976,000$$

$$x = 6,999.49 \text{ being manager's bonus}$$

#### PROOF

Income before manager's bonus and taxes.....	\$150,000.00
Manager's bonus .....	6,999.49
	<hr/>
Income before Taxes.....	\$143,030.51

#### WAR PROFITS TAX:

Exemption .....	53,000.00
	<hr/>
	\$90,030.51 at 80%
	<hr/>
	\$72,024.41

INCOME TAX:		
Income .....		\$143,030.51
Exemption:		
War Profits Tax.....	\$72,024.41	
And .....	2,000.00	
		74,024.41
		<u>\$69,006.10 at 12%</u>
		<u>8,280.73</u>
		<u><u>\$80,305.14</u></u>
Total Taxes .....		
Income before Taxes.....		\$143,030.51
Taxes .....		80,305.14
		<u>\$62,725.37</u>
Net Income to Corporation.....		
	SUMMARY	
Manager's Share .....		\$6,969.49 10%
Corporation's Share .....		62,725.37 90%
		<u>\$69,694.86</u>

# PROBLEM

The manager of a corporation is to receive 10 per cent of the net income after taxes. As the amount to be paid the manager is a proper deduction in calculating the taxes, it becomes necessary to ascertain a sum which when used as a deduction in calculating the taxes will be 10 per cent of the amount remaining for both himself and the corporation after taxes are paid by the corporation.

The following calculation is set forth in a way which will enable anyone with only an elementary knowledge of algebra to understand the solution of the problem.

Assuming the invested capital of the corporation in 1918 to be \$500,000, the income for 1918 \$110,000, and the average pre-war earnings the same, what is the manager's bonus?

Let  $x$  = manager's bonus

## EXCESS PROFITS TAX:

Income .....	\$110,000 — $x$
Exemption: 8% of Invested Capital.....	\$40,000
And .....	3,000 \$ 43,000
20% of Invested Capital, less Exemption.....	57,000
Over 20% of Invested Capital.....	10,000 — $x$
	at 30% \$17,100 — $x$
	at 65% 6,500 — $x$
	100

$$\frac{65}{100} \times \$23,600 = \frac{65}{100} \times \$23,600$$

## INCOME TAX:

Income .....	\$110,000 — $x$
Exemption:	
Excess Profits Tax.....	\$23,600 — $x$
	100

$$\frac{65}{100} \times \$23,600 = \frac{65}{100} \times \$23,600$$

And .....	2,000	$-\frac{65}{100}x$
		$-\frac{21}{500}x$
		$-\frac{346}{500}x$
Total Taxes .....		$-\frac{346}{500}x$
Income .....		$-\frac{346}{500}x$
Taxes .....		$-\frac{346}{500}x$
Net Income for Corporation .....		$-\frac{346}{500}x$

As the manager is to receive 10 per cent of Profits, leaving 90 per cent for the corporation, his share is  $\frac{1}{9}$  of the net income of the corporation, hence:

$$\begin{aligned}
 9x &= \$76,272 - \frac{154}{500}x \\
 9\frac{154}{500}x &= 76,272 \\
 4,654x &= 38,136,000 \\
 x &= 8,194.24 \text{ being manager's bonus}
 \end{aligned}$$



# PROOF

Income before manager's bonus and taxes.....	\$110,000.00
Less: Manager's bonus.....	8,194.24
Income before Taxes.....	<u>\$101,805.76</u>
EXCESS PROFITS TAX:	
Exemption:	
8% of Invested Capital.....	\$40,000
And .....	<u>3,000</u>
20% of Invested Capital, less Exemption.....	\$7,000.00 at 30%
Over 20% of Invested Capital.....	1,805.76 at 65%
	<u>\$18,273.74</u>
	<u>\$101,805.76</u>

INCOME TAX:	
Income .....	\$101,805.76
Exemption:	
Excess Profits Tax.....	\$18,273.74
And .....	<u>2,000.00</u>
	<u>20,273.74</u>
	<u>\$ 81,532.02 at 12%</u>
	<u>9,783.84</u>
	<u><u>\$28,057.58</u></u>

## Total Taxes.....

Income before Taxes.....	\$101,805.76
Taxes .....	28,057.58
Net Income to Corporation.....	<u>\$ 73,748.18</u>

## SUMMARY

Manager's Share.....	\$ 8,194.24	10%
Corporation's Share.....	73,748.18	90%
	<u>\$ 81,942.42</u>	

**Compensation in the form of deductions, etc.**—Article 32, Reg. No. 45, amplifies former rulings in connection with pensions and other items of personal services.

**COMPENSATION FOR PERSONAL SERVICES.—**

**REGULATION.** Where no determination of compensation is had until the completion of the services, the amount received is ordinarily income for the calendar year of its determination or receipt. Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, retired pay of federal and other officers, and pensions or retiring allowances paid by the United States or private persons, are income to the recipients; as are also marriage fees, baptismal offerings, and so-called gifts and contributions received by a clergyman, evangelist or religious worker for services rendered. Premiums paid by an employer on accident or health policies in favor of his employees as additional compensation of such employees are income to the employees. Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. (Reg. No. 45, Article 32.)

## CHAPTER X

### INCOME FROM BUSINESS

**Computation of income of contractors.**—Regulations No. 45 are substantially the same as former procedure except that Article 33 contains the following additional clause: "Upon the completion of the contract if it is found that as a result of such estimate or apportionment the income of any year or years has been overstated or understated, the taxpayer should file amended returns for such year or years."

**Inventories.**—Regulations No. 45 cover in considerable detail the requirements of the Department in respect of inventories. There is no special difference between the regulations and the comments on page 220 *et seq.* It may be noted, however, that Article 1584 rules that market “means the current bid price prevailing at the date of the inventory.” Later on, however, in the same article it is recognized that abnormal conditions prevent the usual procedure regarding the determination of market prices. Generally speaking, an inventory based on current bid prices would enable most inventories taken on November 30, 1918, and subsequently to be priced very low as in many commodities the bid prices were based on over-stocks. The definition in the regulations, therefore, should not be taken literally but should be used in connection with the context.

#### VALUATIONS OF INVENTORIES.—

**REGULATIONS.** Inventories should be valued at (a) cost or (b) cost or market whichever is lower. Whichever basis was adopted by a taxpayer in respect of the taxable year 1917 must be continued unless upon application to the Commissioner permission is granted to change. If basis (b) is used it must be applied to each item in the inventory and not to a part only. Inventories should be recorded in a legible manner and properly computed and summarized and should be preserved as a part of the accounting records of the taxpayer. (Reg. No. 45, Article 1582.)

#### INVENTORIES AT COST.—

Cost means:

(1) In the case of merchandise purchased, the invoice price less trade or other discounts except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased.

(2) In the case of merchandise produced by the taxpayer, (a) the cost of raw materials and supplies entering into or consumed in connection with the product, (b) expenditures for direct labor, (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit.

In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. (Reg. No. 45, Article 1583.)

#### INVENTORIES AT MARKET.—

Market means the current bid price prevailing at the date of the inventory for the particular merchandise, and is applicable to goods purchased and on hand and to basic materials in goods in process of manufacture and in finished goods on hand, exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory. Where no open market quotations are available the taxpayer must use such evidence of a fair market price as may be available to him, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. The burden of proof will rest upon the taxpayer in each case to satisfy the Commissioner of the correctness of the prices adopted. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market has been established during the succeeding year, a claim may be filed in accordance with the provisions of Section 214 (a-12) of the statute for a recomputation of the net income of the preceding taxable year and an adjustment of the income and war excess profits taxes. (Reg. No. 45, Article 1584.)

The foregoing regulations in recognizing abnormal conditions throw a considerable amount of responsibility on the good judgment and good faith of the taxpayer. As provided in the last sentences of Article 1584, it may be necessary to recompute the net income of the preceding taxable year. The article indicates that such computation would result in a claim for refund. The article, however, should also be construed to mean that if the taxpayer has made an estimate which

proves to have been entirely too low, the tax for the preceding year should be recomputed even though it results in considerable additional payment to the government.

In connection with an interpretation of the terms, (a) cost, (b) cost or market, whichever is lower, questions have arisen as to whether certain items in an inventory may be priced at cost (which is less than market) and other items of exactly the same kind, which cost more, will be reduced to market. For illustration, certain lots of pig iron may have cost \$20 per ton. Other lots may have cost \$25 and additional lots may have cost \$30. When inventory is taken the market price is \$25. It has been urged that where the lots can be readily identified the first lot should be kept at cost, viz., \$20 per ton, the second lot should be kept at market, viz., \$25 per ton, and the third lot should be marked down to market, viz., \$25 per ton. If such a method has been followed for many years, irrespective of tax problems, there would be no objection to its continuance but if it were adopted for the first time at the end of the taxable year 1918, the burden of proof would be thrown upon the taxpayer to show that the method adopted clearly reflected the net income for the year.

The attitude of the Department towards the "inflated prices of the war period" is indicated by the following letter:

**RULING.** In response to your inquiry as to the attitude of the Bureau of Internal Revenue toward the work of the Industrial Board of the Department of Commerce, I am glad to assure you not only of my sympathetic interest but of my earnest hope and belief that the board will be helpful to us in a large way.

The bureau is desirous of administering intelligently and constructively the relief provisions of the new revenue act in respect of shrinkages in inventory values, and realizes the difficulty of its task. I am, therefore, following with interest your board's plan to bridge the gap between the inflated prices of the war period and a normal scale of prices for general buying. As I understand it, you intend to accomplish this by joint study on the part of the government and the basic industries of the nation, as a result of which a normal scale of prices may be evolved and presented to national commerce as a fair and sound basis for government buying and the resumption of normal activity.

The bureau will welcome from you evidence which will thus be made available as to post-war prices, and while it cannot be bound by the action of another branch of the government, we will give such evidence the full weight to which it is entitled in administering the tax law. (Letter to George N. Peek, Chairman, Industrial Board, Department of Commerce, from Commissioner Roper, March 15, 1919.)

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ADJUSTMENT OF INVENTORIES AFTER CLOSE OF TAXABLE YEAR.—It has been urged that the measure of loss which may be claimed under Sections 214 (a-12) and 234 (a-14) consists of the difference between the sales price realized and the sales price which the goods were marked to sell at when the books were closed at the end of the taxable year. No such intention can be found in the law. It was intended that taxpayers should secure relief through shrinkage in market prices. The shrinkage related solely to the price paid by the taxpayer and covers the decline in the value of goods on a replacement basis. The only possible relation there could be to sales prices would be those cases where the shrinkage in the sales price is exactly the same as the shrinkage in the market price.

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WHO ARE DEALERS IN SECURITIES?—The new regulations are substantially the same as former procedure, except that formerly to be a dealer the buying and selling of securities had to be the principal business of the taxpayer, whereas under the new regulations it is only necessary that the taxpayer be regularly engaged in buying and selling securities and provision is made for inventories in cases where the security business is merely a branch of the activities of the taxpayer.

INVENTORIES BY DEALERS IN SECURITIES.—

REGULATION. A dealer in securities, who in his books of account regularly inventories unsold securities on hand either (a) at cost or (b) at cost or market value whichever is lower, may make his return upon the basis upon which his accounts are kept; provided that a

description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers, that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, and not in the course of an established business, and officers of corporations and members of partnerships, who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule. (Reg. No. 45, Article 1585.)

**DEALERS IN SECURITIES.**—In preparing returns on form 1040, the taxpayer who has qualified as a dealer in securities would not be required to enter the items of his business in block D, but would use block A. On line 3 there should be entered the sales price of all securities sold and on line 7 there would be entered the cost price of securities purchased. When the dealer has kept his books on an accrual basis and has taken inventories, lines 8 and 10 should be used to record the inventories at the beginning and end of the year. If it is not feasible for a dealer in securities to enter the gross sales price in line 3, because his books show only gross profits, he should then enter the item of gross profits on line 3 and not attempt to set up the cost of securities held on line 7. This method is permissible as it reflects income of the taxpayer based on accepted accounting principles.

But block A is not intended to be used by those who are not dealers in securities. Speculators or investors who may carry on many hundreds of transactions during the year must either qualify as dealers in securities (which they probably cannot) or they must report under block D. It has been urged

that an active trader cannot readily prepare schedules showing the sales price and cost of all securities dealt in. If such trader kept books showing the details of each transaction and if he kept an account showing the gross profits or gross losses on each transaction, it might be permissible to use such totals in block D with an explanation that those figures agreed exactly with regular books of accounts kept by the taxpayer and open to the income tax inspectors. On the other hand, if such taxpayer did not keep regular sets of books which could readily be verified, the Department is fully justified in requiring the detail of every single transaction during the taxable year. If some such compilation is not made, the taxpayer himself does not know what his profits or losses have been and if a compilation is made, there is no reason why a copy of it should not be attached to form 1040 in support of the totals carried into block D.

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**Replacement funds.**—T. D. 2706, April 25, 1918, provided for relief from inequitable taxation in cases where payment was received for property which under normal conditions would be immediately replaced. The decision related only to property destroyed through war hazards. Regulations No. 45 widely extend the procedure to cover all losses to property through fire, storm or other casualty, or where property is taken under the right of eminent domain, etc.

**LOSS OR DAMAGE RECOVERED.—**

**REGULATION.** In the case of property which has been lost or destroyed in whole or in part through fire, storm, shipwreck, or other casualty, or where the owner of property has lost or transferred title by reason of the exercise of the powers of requisition or eminent domain, including cases where a voluntary transfer or conveyance is induced by reason of the fact that a technical requisition or condemnation proceeding is imminent, the amount received by the owner as compensation for the property may show an excess over the value of the property on March 1, 1913, or over its cost, if it was acquired after



that date (after making proper provision in either case for depreciation to the date of the loss, damage or transfer). The transaction is not regarded as completed at this stage, however, if the taxpayer proceeds immediately in good faith to replace the property, or if he makes application to establish a replacement fund as provided in the following article. In such a case the gain, if any, is measured by the excess of the amount received over the amount actually and reasonably expended to replace or restore the property substantially in kind, exclusive of any expenditures for additions or betterments. The new or restored property effects a replacement in kind only to the extent that it serves the same purpose as the property which it replaces without added capacity or other element of additional value. Such new or restored property shall not be valued in the accounts of the taxpayer at an amount in excess of the cost or value at March 1, 1913, if acquired before that date (after making proper provision in either case for depreciation to the date of the loss, damage or transfer) of the original property, plus the cost of any actual additions and betterments. If the taxpayer does not elect to replace or restore the property, the transaction will then be deemed to be completed and the income shall be measured by the excess of the amount of the compensation received over the cost of the property or its actual value at March 1, 1913, if acquired before that date (after making proper provision in either case for depreciation to the date of the loss, damage or transfer). Articles 47, 48 and 49 have no application to property which is voluntarily sold or disposed of. (Reg. No. 45, Article 47.)

#### REPLACEMENT FUND FOR LOSSES.—

**REGULATIONS.** In any case in which the taxpayer elects to replace or restore the lost, damaged or transferred property, but where it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which the entire amount of the compensation so received shall be held, without deduction for the payment of any mortgage, and pending the disposition thereof the accounting for gain or loss thereupon may be deferred for a reasonable period of time, to be determined by the Commissioner. (Reg. No. 45, Article 48.)

#### APPLICATION FOR REPLACEMENT FUND.—

In a case specified in the preceding article the taxpayer should make application to the Commissioner on form 1114 for permission to establish such a replacement fund and in his application should recite all the facts relating to the transaction and undertake that he will proceed as expeditiously as possible to replace or restore such

property. The taxpayer will be required to furnish a bond with such security or surety as the Commissioner may require for an amount not less than the estimated additional excess profits and income taxes assessable by the United States upon the income so carried to the replacement fund; or at the option of the taxpayer and in lieu of such bond the taxpayer may deposit, as security for such estimated additional amount of tax, obligations of the United States issued after September 1, 1917, such obligations to be held in trust as such security under such agreement as may be prescribed by the Commissioner in a bank or trust company approved by him. The estimated additional income and excess profits taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on federal bonds will be approved as sureties under schedule B of form 1114, and only active depositories of public moneys will be approved as depositories under schedule C. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depository may each have a copy. (Reg. No. 45, Article 49.)

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**Income from sale of personal property on the instalment plan.**—Referring to the cost and repossession of automobiles, a dealer of course can mark down the value of repossessed cars to actual value when an inventory is taken but if the adjustment were not made until inventory time, in the meantime the property would be carried on the dealer's books at an inflated price, the result being that the dealer and his creditors might both be deceived. Regulations No. 45 amplify the former regulations and are therefore reproduced in full.

**REGULATIONS.** Dealers in personal property ordinarily sell either for cash, or on the personal credit of the buyer, or on the instalment plan. Occasionally a fourth type of sale is met with, in which the buyer makes an initial payment of such a substantial nature (for example, a payment of more than 25 per cent) that the sale, though involving deferred payments, is not one on the instalment plan. In sales on personal credit, and in the substantial payment type just mentioned, obligations of purchasers are to be regarded as the

equivalent of cash, but a different rule applies to sales on the instalment plan. Dealers in personal property who sell on the instalment plan usually adopt one of four ways of protecting themselves in case of default: (a) through an agreement that title is to remain in the seller until the buyer has completely performed his part of the transaction; (b) by a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the purchase price; (c) by a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the seller; or (d) by conveyance to a trustee pending performance of the contract and subject to its provisions. The general purpose and effect being the same in all of these plans, it is desirable that a uniformly applicable rule be established. The rule prescribed is that in the sale or contract for sale of personal property on the instalment plan, whether or not title remains in the vendor until the property is fully paid for, the income to be returned by the vendor will be that proportion of each instalment payment which the gross profit to be realized when the property is paid for bears to the gross contract price. If, for any reason, the vendee defaults in his instalment payments and the vendor repossesses the property, the entire amount received on instalment payments, less the profit already returned, will be income of the vendor for the year in which the property was repossessed. If the vendor chooses as a matter of consistent practice to treat the obligations of purchasers as the equivalent of cash, such a course is permissible. (Reg. No. 45, Article 39.)

The same point is also covered in the *1919 Income Tax Primer* as follows:

**RULING.** A piano dealer sells an instrument under a contract which states that payment therefor is to be made in monthly instalments. How is the latter to report the amount of profit derived from this transaction?

It is held that every dollar received under such a contract represents in part the return of a portion of the cost of the article to the dealer and a portion of the profit to be derived from the transaction, and that the amount of profit represented by all the payments during the tax year should be reported in the dealer's personal return rendered for that year. For example, a piano which cost the dealer \$300 is transferred to another under a contract calling for 20 monthly payments of \$20 each, a total of \$400. Each monthly payment represents a return of capital amounting to \$15 and a profit amounting to \$5, and multiplying this latter amount by the number of payments received during the year yields the amount to be returned as income for that year.

If for any reason the purchaser defaults in his instalment pay-

ments and the dealer repossesses the property, the entire amount received on the instalment payments less the profit originally returned will be income to the dealer to be so returned for the year in which the property was repossessed, and the property will be taken back into the inventory at its cost. (*Income Tax Primer*, 1919, question 34.)

The intention of the regulations is that each item shall be analyzed in order that a proper allocation of the realized profit may be made. If, however, the average gross profits on all sales is known and it is feasible to make the calculation, the Department no doubt would permit the allocation to be made on the basis of total sales and total collections. Such a method, however, would not be permitted unless it were clearly shown that it reflected the true net income of the taxpayer. When it has been the consistent practice to treat the obligations of purchasers as an equivalent of cash the regulations hold that such a course is permissible. On the other hand, taxpayers who desire to change from such a method to that laid down in the regulations as being the proper method will be permitted to do so, but it is obvious that no such change can be made unless a proper adjustment is made of the prior years. Otherwise the return made by a taxpayer for the year 1918 would not reflect the true net income of such taxable year.

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For attitude of Department regarding amended returns in cases where taxpayers desire to change all or part of their system from cash to an accrual basis, see ruling by Department, February 11, 1919 (page 1077).

## CHAPTER XI

INCOME FROM THE APPRECIATION OF  
PROPERTY VALUES

Page 249

The word "ever" on the ninth line should be "never."

Page 267

**Procedure when property is exchanged for other property.**—Comments on page 267 *et seq.* regarding the procedure when property is exchanged for other property are in practical accord with the new regulations. The subject, however, is of such importance that the regulations are reproduced in full.

**REGULATIONS.** Gain or loss arising from the acquisition and subsequent disposition of property is realized when as the result of a transaction between the owner and another person the property is converted into cash or into property (a) that is essentially different from the property disposed of and (b) that has a market value. In other words, both (a) a change in substance and not merely in form, and (b) a change into the equivalent of cash, are required to complete or close a transaction from which income may be realized. By way of illustration, if a man owning ten shares of listed stock exchanges his stock certificate for a voting trust certificate, no income is realized, because the conversion is merely in form; or if he exchanges his stock for stock in a small, closely held corporation, no income is realized if the new stock has no market value, although the conversion is more than formal; but if he exchanges his stock for a Liberty bond, income may be realized, because the conversion is into independent property having a market value. The exchange of a so-called convertible bond for stock pursuant to such a privilege granted in the bond will produce income if the stock received in exchange has a fair market value in excess of the cost or fair market value as of March 1, 1913, of the bond. (Reg. No. 45, Article 1563.)

**DETERMINATION OF GAIN OR LOSS FROM EXCHANGE OF  
PROPERTY.**—

The amount of income derived in the case of an exchange of property, as of stock for a bond, is the excess of the fair market value at the time of exchange of the bond received in exchange over the

original cost of the stock exchanged for it, or over the fair market price or value of such stock as of March 1, 1913, if acquired before that date. The amount of income derived from a subsequent sale of the bond for cash is the excess of the amount so received over the fair market value of such bond when acquired in exchange for the stock. On the other hand, if the property received in exchange is substantially the same property or has no market value, then no gain or loss is realized, but the new property is to be regarded as substituted for the old and upon a sale of the new property the amount of income derived is the excess of the amount so received over the cost or fair market value as of March 1, 1913, of the old. (Reg. No. 45, Article 1564.)

#### EXCHANGE FOR DIFFERENT KINDS OF PROPERTY.—

(a) If property is exchanged for two different kinds of property, such as bonds and stock, the bonds having a market value and the stock none, the value of the bonds is to be compared with the cost or fair market value as of March 1, 1913, of the original property, as the case may be. If the market value of the bonds is less than such cost or value, the difference represents the cost of the stock. If the market value of the bonds is greater than such cost or value, the difference is taxable income at the time of the exchange and whenever sold the entire proceeds of the stock will be taxable. (b) If property is exchanged for two different kinds of property, such as bonds and stock, neither having a market value, the cost or fair market value as of March 1, 1913, of the original property should be apportioned, if possible, between the bonds and stock for the purpose of determining gain or loss on subsequent sales. If no fair apportionment is practicable, no profit on any subsequent sale of any part of the bonds or stock is realized until out of the proceeds of sales shall have been recovered the entire cost or fair market value as of March 1, 1913, of the original property. (Reg. No. 45, Article 1565.)

#### EXCHANGE OF STOCK FOR OTHER STOCK OF NO GREATER PAR VALUE.—

In general, where two corporations unite their properties by either (a) the dissolution of corporation B and the sale of its assets to corporation A, or (b) the sale of its property by B to A and the dissolution of B, or (c) the sale of the stock of B to A and the dissolution of B, or (d) the merger of B into A, or (e) the consolidation of the corporations, no taxable income is received from the transaction by A or B or the stockholders of either, provided the sole consideration received by B and its stockholders in (a), (b), (c) and (d) is stock or securities of A, and by A and B and their stockholders in (e) is stock or securities of the consolidated corporation, in any

case of no greater aggregate par or face value than the old stock and securities surrendered. For the purpose of ascertaining the gain derived or loss sustained from the subsequent sale of any stock of A or of the consolidated corporation so received, the original cost to the taxpayer or the fair market price or value as of March 1, 1913, of the stock of B or A in respect of which the new stock was issued, less any untaxed distribution made to the taxpayer by A out of the former capital or surplus of B, or by the consolidated corporation out of the former capital or surplus of A or B, is the basis for determining the amount of such gain or loss. (Reg. No. 45, Article 1566.)

#### EXCHANGE OF STOCK FOR OTHER STOCK OF GREATER PAR VALUE.—

If in the case of any reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock and securities exchanged, income will be realized from the transaction by the recipients of the new stock or securities to an amount limited by (a) the excess of the par or face value of the new stock or securities over the par or face value of the old and (b) the excess of the fair market value of the new stock or securities over the cost or fair market value as of March 1, 1913, of the old. In other words, the taxable profit will be (a) or (b), whichever is less. Upon a subsequent sale of the new stock or securities their cost to the taxpayer will be the cost or fair market value as of March 1, 1913, of the old stock and securities, plus the profit taxed on the exchange. (Reg. No. 45, Article 1567.)

It is important to note that the foregoing regulations recognize the principle that in connection with exchanges of property there must be a change in substance and not merely in form and that there must be a payment in the equivalent of cash. This is the principle upon which the author has based his rather extended arguments in *Income Tax Procedure* 1917 and 1918.

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**Sale of goodwill.**—The procedure of the Department as indicated in a letter to a taxpayer is confirmed by Article 38 of Reg. No. 45, which is as follows:

**REGULATION.** Any profit or loss resulting from an investment in goodwill can be taken only when the business, or a part of it, to

which the goodwill attaches is sold, in which case the profit or loss will be determined upon the basis of the cost of the assets, including goodwill, or their fair market value as of March 1, 1913, if acquired prior thereto. If nothing was paid for goodwill acquired after February 28, 1913, no deductible loss is possible, although, on the other hand, upon the sale of the business there may be a profit. It is immaterial that goodwill may never have been carried on the books as an asset, but the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the goodwill sold. (Reg. No. 45, Article 38.)

## CHAPTER XIII

### INCOME FROM INTEREST

Page 293

**Income from non-taxable securities.**—Interest received which is entirely exempt from taxation formerly did not have to be reported at all but under the 1918 law a report must be made thereof. This point is covered by line 11 on page 1, form 1040, in which must be stated the class of securities, principal and interest thereon. The classes of securities are the bonds of the first Liberty loan, other obligations of the United States issued before September 1, 1917, obligations of the United States possessions, states and territories, political sub-divisions thereof and federal farm loan bonds.

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**Exemptions under Victory Liberty Loan.**—The law known as the "Victory Liberty Loan Act," March 3, 1919, gives to the Secretary of the Treasury wide powers in connection with the next and what is supposed to be the final Liberty loan. The additional exemptions will be of considerable interest within the near future. The following summary of the new provisions is taken from the *Wall Street Journal*, March 5, 1919.



Through the further exemptions provided by the Victory Liberty loan, it is possible for an owner of Liberty Bonds other than the  $3\frac{1}{2}$ 's to be exempt from super-taxes and excess and war profits taxes, to an aggregate amount of \$160,000 of Liberty Bonds, under certain conditions.

Before the passage of the Victory Liberty Loan Act a possible aggregate of \$110,000 on second, third and fourth Liberty loan bonds could be exempt from the super taxes, etc., until two years after the termination of the war. This was provided as follows:

(Note: For description of exemption conditions, see pages 298-299.—Author.)

The new measure extends two more tax-exemption privileges. In addition to all the foregoing, and for a period of five years after the termination of the war (not two years, as above), the interest on an aggregate amount of \$30,000 of the first Liberty loan converted, the second Liberty loan converted and unconverted and the third and fourth Liberty loans, owned by any individual, corporation, etc., is exempt as to the super-taxes. The exemption only applies on interest received on and after January 1, 1919.

Then another principal of \$20,000 of bonds mentioned in the preceding paragraph is exempted as to the super-taxes on the interest received after January 21, last, by virtue of an original subscription to Victory Liberty loan notes; but claim for such exemption cannot be made by any holder to an amount of such bonds exceeding three times the principal amount of his subscriptions to the Victory Liberty loan. To participate to the extent of the aggregate of \$20,000, therefore, a subscriber must purchase \$6,650 of the new notes.

Thus there is an aggregate additional principal exemption from super-taxes of \$50,000 in respect of existing bond issues provided in the new loan measure.

It should be noted that no time is specified in respect of the tax exemption on the last \$20,000, although, of course, the exemption privilege is extended in respect of an original Victory Liberty loan subscription and still owned at the date of the tax return.

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**Exemptions to holding companies.**—Inquiries have been made as to the extent to which affiliated companies would secure the benefit of the exemptions to which subscribers of the fourth Liberty loan were entitled. Reference should be made to Section 7 of the second Liberty loan act as amended, which provides that the exemptions up to \$110,000 run to any individual or corporation. In order to secure the full benefit

of the exemptions it will be necessary, however, for each corporation which is affiliated with others to have original its subscription recorded.

Page 299

**Calculation of the exemption of beneficiaries and partners.**—In cases of trusts, partnership and personal service corporations the calculation of exemptions are as follows:

**LIBERTY BOND EXEMPTION IN THE CASE OF TRUSTS.—**

**REGULATIONS.** (a) When income is taxable to beneficiaries, as in the case of a trust the income of which is to be distributed to the beneficiaries periodically, each beneficiary is regarded as the owner of a proportionate part of the bonds held in trust and is entitled to exemption on account of such ownership as if he owned such proportionate part of the bonds directly. In such a case a subscription by a trustee for bonds of the fourth Liberty loan constitutes each beneficiary existing at the time of such subscription an original subscriber for his proportionate part of such bonds and entitles such beneficiary to the collateral exemption of interest on bonds of previous issues, whether owned by such beneficiary or by the trustee, as if the beneficiary had himself originally subscribed for such proportionate part of the bonds, and a subscription by such beneficiary for bonds of the fourth Liberty loan entitles him to the collateral exemption of interest on bonds of previous issues held by the trustee. (b) When, on the other hand, income is taxable to the trustee, as in the case of a trust the income of which is accumulated for the benefit of unborn or unascertained persons, the trustee is regarded as the owner of all the bonds held in trust and the trust is entitled to any exemption on account of such ownership. In such a case a subscription by a trustee constitutes the trustee as such the original subscriber and entitles the trust, on account of such subscription, to the collateral exemption of interest on bonds of previous issues. (Reg. No. 45, Article 79.)

**LIBERTY BOND EXEMPTION IN THE CASE OF PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS.—**

As income of a partnership is taxable to the individual partners, each partner is treated and entitled to exemption on account of such ownership as if such partner owned such proportionate part of the bonds directly. Such partner, if a partner at the time of the original subscription by the partnership for bonds of the fourth Liberty loan, is treated as an original subscriber for a proportionate part of such bonds subscribed for by the partnership and is entitled to the

collateral exemption of interest on bonds of previous issues on account of such original subscription for bonds of the fourth Liberty loan as if he had subscribed directly for such proportionate part of the bonds. This principle applies also to stockholders in personal service corporations. (Reg. No. 45, Article 80.)

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**Determination of Liberty bond interest.**—As the exemption of \$5,000 applies to all holdings, a separate statement must be made whenever there was a change during the year, and when a return is being made on a receipt basis, the coupon dates must also be taken into account as one of the changes in order to show the proper distribution of the income.

Where there were many transactions during the year in Liberty bonds the work involved in making an accurate return is very considerable and without a proper segregation of the various issues and the actual interest collection, it is quite possible that part of the exemption will be lost.

When accrued interest has been paid out on bonds purchased and a return must be made for a period which ends before the interest falls due, the regulation that such accrued interest is deductible from the succeeding interest collection must be modified to accord with the accrual basis of accounting. This merely means that the amount of interest paid out will be deducted from the amount of interest accrued to the end of the accounting period. (See item 25 of form on following pages for calculating tax-exempt interest.)

It will be found that this form will be somewhat easier to follow than directions K (b), page 2 of instructions, form 1040.

**Determination of exempt Liberty bond interest.**—The Department has issued no complete form for the calculation of tax-exempt interest on Liberty bonds and a supplementary statement is required to be submitted when the face value of bonds held exceeds the exemption limits, but the directions are not translated into terms of a workable formula. While

the calculation of exemptions is so complex that no simple method can be devised to provide for all cases, the suggested form on the following page will enable taxpayers who hold various issues of Liberty bonds to determine the allowable exemption. A space is provided for each interest date so that the exemptions may be figured for each half year.

No other method can be depended upon to extract from the sum of interest received from all issues the maximum amount that is subject to tax under the law. Taxpayers who have held bonds throughout a semi-annual period in amounts exceeding the exemption limits should segregate any accrued interest received on bonds sold. Such accrued interest would be subject to tax, but exemptions should be calculated from bonds retained, on which interest has been received for a full six months' term.

# Exemptions from Federal Taxation of Interest on Federal Obligations Allowed by Law to Individuals, Partnerships, Associations and Corporations

Obligation	Interest is Exempt—	Duration of Exemption Privilege
3½% First Liberty Bonds, original issue, unconverted. Certificates of Indebtedness issued under First Liberty Bond Act.	From all taxation, present or future, except estate or inheritance taxes.*	No limitation.
4¼% Fourth Liberty Bonds, original issue.	(a) From normal income taxes. (b) From surtaxes and excess profits and war-profits taxes only to the extent of interest on an amount of principal not exceeding \$30,000.	(a) No limitation. (b) Until the expiration of two years after the date of the termination of the war between the United States and Germany as fixed by proclamation of the President.
4¼% First Liberty Bonds converted into Fourth Loan.	(a) From normal income taxes. (b) From surtaxes and excess profits and war-profits taxes only to the extent of interest on an amount of principal not exceeding \$30,000.	(a) No limitation. (b) Until the expiration of two years after the date of the termination of the war between the United States and Germany as fixed by proclamation of the President.
4% First Liberty Bonds converted into Second Loan. 4¼% First Liberty Bonds, converted into Third Loan. 4% Second Liberty Bonds, original issue, unconverted. 4¼% Second Liberty Bonds, converted into Third Loan. 4¼% Third Liberty Bonds, original issue, unconverted.	(a) From normal income taxes. (b) From surtaxes and excess profits and war-profits taxes only to the extent of interest received after January 1, 1918, on an aggregate† principal amount of \$45,000 of these bonds, provided that the exemption shall be limited in all cases to interest on an amount of bonds one and one-half times the principal amount of the Fourth Liberty Loan originally subscribed for, and still owned by the taxpayer, at the date of tax return.	(a) No limitation. (b) Until the expiration of two years after the date of the termination of the war between the United States and Germany as fixed by proclamation of the President.
All Liberty Bonds enumerated above except 3½% First Loan, original issue. Certificates of Indebtedness issued after September 1, 1917, under Liberty Bond Acts. War-Savings Certificates.	(a) From normal income taxes. (b) From surtaxes and excess profits and war-profits taxes only to the extent of interest on an aggregate† amount of principal not exceeding \$5,000.	(a) No limitation. (b) No limitation.
Postal Savings Bonds and any Obligations of the United States issued prior to September 2, 1917, other than those enumerated above.	From all income and excess profits and war-profits taxes.	No limitation.
Obligations of Possessions of the United States.	From all income and excess profits and war-profits taxes.	No limitation.
Securities Issued under Federal Farm Loan Act of July 17, 1916.	From all income and excess profits and war-profits taxes.	No limitation.
Bonds Issued by War Finance Corporation.	(a) From normal income taxes. (b) From surtaxes and excess profits and war-profits taxes only to the extent of interest on an amount of principal not exceeding \$5,000.	No limitation.

\*But under the estate tax law and regulations only the interest accrued to the day of death is to be included in the gross estate. Interest accruing to the estate after the day of death is not subject to the estate tax. See Act of September 8, 1916; T. D. 2406 dated December 2, 1916; and Regulations No. 37 Revised, Article IX.

†The use of the word "aggregate" does not mean that the exemption must be claimed with respect to all the bonds held by any taxpayer. In order to claim the maximum exemption permitted by law, the taxpayer should select the particular issue, or issues, of bonds which show the largest ratio of interest to principal. See directions given on the suggested form shown on the following page.

‡It has been announced that the names of subscribers to \$1,000 of Liberty Bonds or more would be card-catalogued at Washington "in view of certain tax exemptions enjoyed by owners of the Fourth Liberty Loan."—*New York Times*, December 12, 1918.

**SUGGESTED FORM FOR YEAR 1918**  
**FOR CALCULATION OF AMOUNTS OF TAX EXEMPT AND TAXABLE INTEREST RECEIVED ON**  
**U. S. LIBERTY BONDS AND CERTIFICATES**

TAXPAYER		(NAME OF INDIVIDUAL, PARTNERSHIP, ASSOCIATION OR CORPORATION)										ADDRESS																																		
LINE	DATE OF BOND	ISSUE	RATE	DATE OF MATURITY	INTEREST DATE	INTEREST RECEIVED (1) INCLUDING ACCRUED INTEREST ON BONDS SOLD		TAX EXEMPT INTEREST				CALCULATION OF EXEMPTIONS IF FACE VALUE OF BONDS HELD IS LESS THAN EXEMPTION LIMITS, INTEREST IS ENTIRELY EXEMPT; IF GREATER, DIRECTIONS GIVEN BELOW FOR DETERMINING PROPORTION WHICH IS TAX EXEMPT.																																		
						FACE VALUE OF CORRESPONDING BONDS A	AMOUNT OF INTEREST B	PRINCIPAL C	INTEREST D																																					
1	NOV. 15 1917	1ST CONVERSION INTO 4TH	4%	1935-1947	JUNE 15							<b>\$45,000 EXEMPTION (2) (3)</b> <b>ALLOWABLE WITH RESPECT TO ANY BOND OR GROUP OF BONDS IN THIS SECTION.</b> Select any issue showing largest ratio of interest (B) to face value (A). <b>RULE 1.</b> If face value of issue selected is greater than principal of allowable exemption, divide A into principal of allowable exemption, multiply resulting percentage into B and enter answer in D. <b>RULE 2.</b> If, on the other hand, face value of issue selected is not greater than principal of allowable exemption, enter interest (B) in D on same line. Proceed as in Rule 1 or Rule 2 until exemption is exhausted.																																		
2	NOV. 15 1917	2ND ORIGINAL	4%	1937-1942	MAY 15																																									
3	MAY 9 1918	1ST CONVERSION INTO 4TH	4 1/2%	1935-1947	JUNE 15																																									
4	MAY 9 1918	2ND CONVERSION INTO 4TH	4 1/2%	1937-1942	MAY 15																																									
5	MAY 9 1918	3RD ORIGINAL	4 1/2%	1938	MAR. 15																																									
6	TOTALS (SUM OF LINES 1 TO 5 INC.)																																													
7	OCT. 24 1918	1ST CONVERSION INTO 4TH	4 1/2%	1935-1947	JUNE 15	A7	B7	C7	D7			<b>\$30,000 EXEMPTION</b> \$30,000 divided by A7 (if more than \$30,000) times B7 - tax exempt interest. <b>\$30,000 EXEMPTION</b> \$30,000 divided by A8 (if more than \$30,000) times B8 - tax exempt interest. <b>\$5,000 EXEMPTION</b> <b>ALLOWABLE WITH RESPECT TO ANY OBLIGATION OR GROUP OF OBLIGATIONS ON LINES 1 TO 9.</b> Follow same procedure as in the case of \$45,000 exemption. Enter tax exempt interest on line 10. Show details of calculations on separate sheet.																																		
8	OCT. 24 1918	4TH ORIGINAL	4 1/2%	1938-1939	APR. 15	A8	B8	C8	D8																																					
9	CERTIFICATE OF INTEREST	DEBITED								X	XXX XX																																			
10	TOTALS									D10																																				
11	NOV. 15 1917	1ST CONVERSION INTO 4TH	4%	1935-1947	DEC. 15																																									
12	NOV. 15 1917	2ND ORIGINAL	4%	1937-1942	NOV. 15																																									
13	MAY 9 1918	1ST CONVERSION INTO 4TH	4 1/2%	1935-1947	DEC. 15							<b>\$45,000 EXEMPTION (2) (3)</b> <b>ALLOWABLE WITH RESPECT TO ANY BOND OR GROUP OF BONDS IN THIS SECTION.</b> Select any issue showing largest ratio of interest (B) to face value (A). <b>RULE 1.</b> If face value of issue selected is greater than principal of allowable exemption, divide A into principal of allowable exemption, multiply resulting percentage into B and enter answer in D. <b>RULE 2.</b> If, on the other hand, face value of issue selected is not greater than principal of allowable exemption, enter interest (B) in D on same line. Proceed as in Rule 1 or Rule 2 until exemption is exhausted.																																		
14	MAY 9 1918	2ND CONVERSION INTO 4TH	4 1/2%	1937-1942	NOV. 15																																									
15	MAY 9 1918	3RD ORIGINAL	4 1/2%	1938	SEPT. 15																																									
16	TOTALS (SUM OF LINES 11 TO 15 INC.)										D16																																			
17	OCT. 24 1918	1ST CONVERSION INTO 4TH	4 1/2%	1935-1947	DEC. 15	A17	B17	C17	D17																																					
18	OCT. 24 1918	4TH ORIGINAL	4 1/2%	1938-1939	OCT. 15	A18	B18	C18	D18																																					
19	CERTIFICATE OF INTEREST	DEBITED								X	XXX XX	<b>\$5,000 EXEMPTION</b> <b>ALLOWABLE WITH RESPECT TO ANY OBLIGATION OR GROUP OF OBLIGATIONS ON LINES 11 TO 19.</b> Follow same procedure as in the case of \$45,000 exemption. Enter tax exempt interest on line 20. Show details of calculations on separate sheet.																																		
20	TOTALS									D20																																				
<table border="1"> <thead> <tr> <th colspan="2">SUMMARY</th> <th>INTEREST RECEIVED</th> <th>TAX EXEMPT INTEREST</th> <th>TAXABLE INTEREST</th> </tr> </thead> <tbody> <tr> <td>21</td> <td>INTEREST RECEIVED AS OF FIRST SIX MONTHS. INTEREST TAX EXEMPT = D6 + D7 + D8 + D10</td> <td></td> <td></td> <td></td> </tr> <tr> <td>22</td> <td>INTEREST RECEIVED AS OF SECOND SIX MONTHS. INTEREST TAX EXEMPT = D16 + D17 + D18 + D20</td> <td></td> <td></td> <td></td> </tr> <tr> <td>23</td> <td>INTEREST RECEIVED ON 3 1/2% 1ST LOAN ORIGINAL ISSUE TAX EXEMPT</td> <td></td> <td></td> <td>X XXX XXX XX</td> </tr> <tr> <td>24</td> <td>TOTALS</td> <td></td> <td></td> <td></td> </tr> <tr> <td>25</td> <td>DEDUCT: ACCRUED INTEREST PAID ON BONDS PURCHASED WHEN INTEREST HAS NOT BEEN RECEIVED ON SAME DURING TAXABLE YEAR.</td> <td></td> <td>X XXX XX</td> <td></td> </tr> <tr> <td>26</td> <td>NET TOTAL</td> <td></td> <td></td> <td>(4)</td> </tr> </tbody> </table>												SUMMARY		INTEREST RECEIVED	TAX EXEMPT INTEREST	TAXABLE INTEREST	21	INTEREST RECEIVED AS OF FIRST SIX MONTHS. INTEREST TAX EXEMPT = D6 + D7 + D8 + D10				22	INTEREST RECEIVED AS OF SECOND SIX MONTHS. INTEREST TAX EXEMPT = D16 + D17 + D18 + D20				23	INTEREST RECEIVED ON 3 1/2% 1ST LOAN ORIGINAL ISSUE TAX EXEMPT			X XXX XXX XX	24	TOTALS				25	DEDUCT: ACCRUED INTEREST PAID ON BONDS PURCHASED WHEN INTEREST HAS NOT BEEN RECEIVED ON SAME DURING TAXABLE YEAR.		X XXX XX		26	NET TOTAL			(4)
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**EXPLANATIONS**

- (1) Amount of interest received must be net after deducting any accrued interest paid on respective bonds purchased or converted. If taxpayer is a partner, include share of partnership principal and interest. If taxpayer is a beneficiary of annual or regular distributions of income, include share of principal and interest of bonds held by trustee.
- (2) The \$45,000 exemption is conditioned upon subscription and ownership of 4th Liberty Bonds. State amount of subscription \$..... and amount owned at date of tax return \$..... of 4th Liberty Bonds, original issue. If either amount is less than \$45,000, allowable exemption is 1 1/2 times whichever amount is lower; if both amounts are greater than \$45,000, allowable exemption is \$45,000. If taxpayer is a partner include share of partnership 4th Liberty Bonds subscribed for and owned at date of tax return. If taxpayer is a beneficiary of annual or regular distributions of income, include share of 4th Liberty Bonds subscribed for and held by trustee.
- (3) The \$45,000 exemption applies to interest actually received after January 1, 1918, but not to interest received prior to that date.
- (4) This amount is not necessarily taxable, but when combined with other items of taxable income less allowable deductions may be subject to surtax and excess profits and war profits taxes.

**NOTE APPLICABLE TO ALL EXEMPTIONS:** Taxpayers should select the exemptions—where a choice is offered—from the bonds on which full term interest has been received rather than from bonds sold on which interest has been accrued for a fraction of the period.

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Page 303

**Interest on war savings certificates.**—The last three sentences on page 303, commencing "No other method" do not relate to war savings certificates but to the form for the calculation of exempt interest on pages 1104 and 1105.

Page 312

**Annuities.**—Article 44 of Reg. No. 45 treats annuities more in detail than heretofore. No changes in former procedure are made but some material is added.

**REGULATION.** Annuities paid by religious, charitable and educational corporations under an annuity contract are subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds any amounts paid by him as consideration for the contract. An annuity charged upon devised land is income taxable to the annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not required to return as taxable income the amount of rent paid to the annuitant, and he is not entitled to deduct from his taxable income any sums paid to the annuitant. Where an insured receives under life insurance endowment or annuity contracts, sums in excess of the premiums paid therefor, such excess is income for the year of its receipt. Distributions on paid-up policies which are made out of earnings of the insurance company subject to tax are in the nature of corporate dividends and are income of an individual only for the purpose of the surtax. (Reg. No. 45, Article 44.)

## CHAPTER XIV

### INCOME FROM RENTS

Page 318

**Income from rents.**—The author has been informed that taxpayers are being advised that rents should only be reported as income when actually collected in cash, but that all expenses, such as interest, insurance and repairs should be claimed as deductions on the accrual basis. It is impossible that such a method would clearly reflect the true net income of

a taxpayer. Therefore any taxpayer who follows such advice could expect to be penalized. Taxpayers who do not keep books will probably always be permitted to report on a cash basis, but no taxpayer can expect to be allowed to return his expenses on an accrual basis and his income on a cash basis.

## CHAPTER XV

### INCOME FROM DIVIDENDS

Page 325

**When owners of record are not legal owners.**—In many cases stocks are owned by others than shareholders of record. Care should be taken to observe the following regulation:

#### RETURN OF CORPORATE DIVIDENDS.—

**REGULATION.** Dividends on stock of domestic corporations or resident alien corporations are prima facie income of the record owner of the stock, and such record owner will be liable for any additional tax based thereon, unless a disclosure of the actual ownership is made to the Commissioner on form 1087 (revised) which shall show that the record owner is not the actual owner and who the owner is and his address. In all cases where the actual owner is a non-resident alien individual and the record owner is a person in the United States, the record owner will be considered for tax purposes to have the receipt, custody, control and disposal of the dividend income and will be required to make return for the actual owner, regardless of the amount of the income, and to pay any surtax found by such return to be due. (Reg. No. 45, Article 404.)

Page 326

**Allocation of dividends to prior periods.**—Extended arguments are appearing in the newspapers in support of the contention that dividends declared during the first 60 days of any taxable year should be taxed at the rates in force during the year when the earnings were deemed to have accumulated. It is contended that members of Congress did not expect that Section 201 (e) would be interpreted as in Reg. No. 45, Article



1541, which states: "Dividends are income and are taxed at the rates for the year in which paid regardless of when the earnings or profits out of which they were paid were accumulated." Exception is made as to stock dividends received by taxpayers between January 1 and November 1, 1918, or declared during such period and received before March 25, 1919. The regulations hold that Section 201 (e) affects invested capital only. The 1917 law did not have the 60-day provision, and it was extremely difficult to determine the effect of cash dividends on invested capital. The 1918 law makes computation definite and therefore easy. During the progress of the bill through the House of Representatives, the Senate and the Conference Committee, several prominent lawyers were in Washington in the interests of corporations which had declared large cash dividends during the early part of 1918 under the then existing law and many attempts were made to secure a modification of the announced change of policy. As a matter of fact the bill as reported by the Finance Committee to the Senate contained a provision known as 201 (d), which fully restored the provisions of the 1917 law, but this provision was subsequently changed in the Senate and made applicable only to stock dividends. There was no misunderstanding on the part of the framers of the law as to what they were doing and it cannot be expected that any court will ever find the law as it now stands to be ambiguous. Most of the big special cash dividends paid during the early part of the year 1918 would not have been paid except for the representations made by the framers of the 1917 law. If relief is to be had it will require action by the next session of Congress.

Page 329

**Distributions which are not dividends.**—The new regulations summarize the cases where distributions are not taxable as dividends.

**REGULATION.** A distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of any assets

except earnings or profits accumulated since February 28, 1913, is not a dividend within the meaning of the statute. A distribution by a personal service corporation out of earnings or profits accumulated since December 31, 1917, is not a dividend. A distribution out of earnings or profits accumulated before March 1, 1913, is free from tax as a dividend; out of assets other than earnings or profits accumulated since February 28, 1913, may or may not be free from tax, according as each stockholder receives more or less than he paid for his stock or its fair market value as of March 1, 1913; and, in the case of a personal service corporation, out of earnings or profits accumulated since December 31, 1917, is taxed to the stockholders as though they were partners. (Reg. No. 45, Article 1542.)

As the foregoing regulation refers only to the non-taxability of such distributions, the procedure must be related to the other provisions of the law and regulations and it will be noted that there is no intention to alter the rule that earnings accumulated since March 1, 1913, must first have been distributed before the earnings accumulated prior to that date can be distributed free from the tax.

Page 334

**Dividends from depletion reserves.**—There is no material change in former procedure, but there are a few verbal changes in the new regulations.

**REGULATION.** A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of its surplus out of which ordinary dividends may be paid. A distribution made from such a reserve will be considered a liquidating dividend and will constitute taxable income to a stockholder only to the extent that the amount so received is in excess of the cost or fair market value as of March 1, 1913, of his shares of stock. No distribution, however, will be deemed to have been made from such a reserve except to the extent that the amount paid exceeds the surplus and undivided profits of the corporation. In general, any distribution made by a corporation other than out of earnings or profits accumulated since February 28, 1913, is to be regarded as a return to the stockholder of part of the capital represented in his shares of stock, and upon a subsequent sale of such stock his profit will be the excess of the selling price over the cost of the stock or its fair market value as of March 1, 1913, after applying on such cost or value the amount of any such capital distribution. (Reg. No. 45, Article 1548.)

**Liquidation dividends.**—As stated on page 337 and as provided by Section 201 (c) of the law, no provision is made for that part of the surplus of a corporation paid out as a liquidation dividend so far as the exemption of the normal tax is concerned.

**REGULATION.** So-called liquidation or dissolution dividends are not dividends within the meaning of the statute, and amounts so distributed, whether or not including any surplus earned since February 28, 1913, are to be regarded as payments for the stock of the dissolved corporation. Any excess so received over the cost of his stock to the stockholder, or its fair market price or value as of March 1, 1913, if acquired prior thereto, is a taxable profit. A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock. (Reg. No. 45, Article 1547.)

As stated on page 338, care should be taken to designate part of the liquidating dividend as from accumulated surplus in order that the full benefit of the credit for the normal tax will be secured.

**Dividends received from personal service corporations.**—

It should be noted that dividends from personal service corporations derived from earnings accumulated after January 1, 1918, are to be treated as income from a partnership. Therefore income received by the personal service corporation, such as tax-exempt interest or dividends from federal land banks or national farm loan associations, should be reported to the stockholders separately, in order that the exemption to which the stockholders are entitled may be secured. In making return on form 1040 the stockholders should segregate the receipts from personal service corporations after Jan-

uary 1, 1918, and not include under block K (a) any dividends which constitute a distribution of profits accumulated after January 1, 1918. The part of the undistributed income of the personal service corporation which accrued to the stockholders after January 1, 1918, should be reported under block C of form 1040. The income received from personal service corporations must also be reported in detail in line 14 on page 1 of form 1040. Dividends received by stockholders of personal service corporations after January 1, 1918, which constitute a distribution of earnings prior to that date should be reported in block K (a). All dividends paid by personal service corporations during the first 60 days of 1918 would be assumed to be taxable as dividends and applicable to the period prior to January 1, 1918, but as the 60-day provision relates only to invested capital and as personal service corporations do not have to compute their invested capital, there would seem to be no reason why the distributions by a personal service corporation during the first 60 days of 1918 should not be deemed to have been out of earnings accrued subsequent to January 1, 1918, if such were in fact the case. The personal service corporation, if its fiscal year ended December 31, 1917, or subsequently has adjusted its returns as of that date in case its fiscal year ended during 1918, will have paid the normal tax on all earnings accumulated to December 31, 1917, and will have paid no income tax for the period from January 1, 1918. Therefore, the individual stockholders of personal service corporations can disregard any adjustments on fiscal year basis and must pay the surtax only on any dividends received after January 1, 1918, which are reported to them as having been paid from earnings accumulated prior to that date. Stockholders of personal service corporations must be careful not to make any return based on the readjustment by the corporation itself for the earnings apportioned to the year 1917 when the corporation's fiscal year ends during 1918. All dividends received by an individual stockholder prior to January 1, 1918,

will have been reported by such stockholder as dividends and the surtax thereon will have been assessed against the stockholders.

## CHAPTER XVI

### INCOME FROM STOCK DIVIDENDS

Page 350

**Stock dividends.**—The new regulations make no change in any of the 1918 regulations, and merely supplement the procedure outlined in the text.

Any stock dividend received by a taxpayer between January 1 and November 1, 1918, or declared and credited to a stockholder during such period and received by him before the expiration of thirty days after the passage of the statute, is deemed to have been paid from the most recently accumulated earnings or profits and shall be taxed to the recipient at the rates prescribed for the years in which the corporation accumulated the earnings or profits so distributed. Thus, such a stock dividend will be deemed to have been paid from the earnings of 1918 (unless paid during the first sixty days of 1918), and the recipient, if an individual, will be liable to any surtax at the rates for the year 1918, unless at the time such dividend was paid or credited the current earnings up to that time were not sufficient to cover the distribution, in which case the excess over the earnings of the taxable year will be deemed to have been paid from the most recently accumulated surplus of prior years and will be taxed at the rate or rates for the year or years in which earned. A corporation declaring and paying such a stock dividend out of earnings accumulated over a period of years should make a record in its books of the amount of the dividend paid out of each year's undistributed profits and advise the stockholders accordingly. (Reg. No. 45, Article 1545.)

The method of reporting stock dividends provided in form 1040, line 12, is not clear. Reference is made only to dividends which were declared out of earnings which accumulated prior to January 1, 1918. There is, of course, no doubt but that stock dividends paid on and after March 2, 1918, out of 1918 earnings are under the 1918 law taxed in the

same manner as cash dividends, but no reference thereto is made in form 1040.

## CHAPTER XVII

### INCOME FROM PARTNERSHIPS, LIMITED PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS

Page 369

**General ownership.**—Ordinarily when two or more persons are associated together for the purpose of conducting a business for profit, they are deemed to constitute a partnership. The following article points out where certain relationships do not constitute a partnership.

#### JOINT OWNERSHIP AND JOINT ADVENTURE.—

**REGULATION.** Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership. Co-owners of oil lands engaged in the joint enterprise of developing the property through a common agent are not necessarily partners. In the absence of special facts affirmatively showing an association or partnership, where a vessel is owned by several individuals and operated by a managing owner or agent for the account of all, the relation does not constitute either a joint-stock association or a partnership. The participation of two United States corporations in a joint enterprise or adventure does not constitute them partners. (Reg. No. 45, Article 1507.)

Page 369

**Domestic partnerships.**—The following regulation is of interest.

**REGULATION.** A domestic corporation or partnership is one organized or created in the United States, including only the states, the territories of Alaska and Hawaii, and the District of Columbia, and a foreign corporation or partnership is one organized or created outside the United States as so defined. The nationality or residence of members of a partnership does not affect its status. A partner-

ship created by articles entered into in San Francisco between residents of the United States and residents of China is a domestic partnership. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is sometimes referred to in the regulations as a resident foreign corporation and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein as a non-resident foreign corporation. (Reg. No. 45, Article 1508.)

#### Page 374

The second line on page 374 reads: "apply against the 1917 income tax, not against 1918 income." This line should read "apply against the 1917 income, not against 1918 income."

#### Page 381

**Limited partnerships.**—The new regulations contain additional matter, but do not change the general provision of the former procedure.

#### LIMITED PARTNERSHIP AS PARTNERSHIP.—

**REGULATIONS.** So-called limited partnerships of the type authorized by the statutes of New York and most of the states are partnerships and not corporations within the meaning of the statute. Such limited partnerships, which cannot limit the liability of the general partners, although the special partners enjoy limited liability so long as they observe the statutory conditions, which are dissolved by the death or attempted transfer of the interest of a general partner, and which cannot take real estate or sue in the partnership name, are so like common law partnerships as to render impracticable any differentiation in their treatment for tax purposes. Michigan and Illinois limited partnerships are partnerships. A California special partnership is a partnership. (Reg. No. 45, Article 1505.)

#### LIMITED PARTNERSHIP AS CORPORATION.—

On the other hand, limited partnerships of the type of partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and of a few other states are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, and capable of holding real estate and bringing suit in the common name, are more truly corporations than partnerships and must make returns of income

and pay the tax as corporations. The income received by the members out of the earnings of such limited partnerships will be treated in their personal returns in the same manner as distributions on the stock of corporations. In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. Michigan and Virginia partnership associations are corporations. Such a corporation may or may not be a personal service corporation. (Reg. No. 45, Article 1056.)

Page 383

**Personal service corporations.**—As the term “personal service corporation” is first used in the 1918 law, the first regulations dealing with this class of taxpayers appear in Regulations No. 45 as follows:

**REGULATION.** In order that a corporation may be deemed to be a personal service corporation its earnings must be derived principally from compensation for personal services rendered by the corporation to the persons with whom it does business. Merchandising or trading either directly or indirectly in commodities or the services of others is not rendering personal service. Conducting an auction, agency, brokerage, or commission business strictly on the basis of a fee or commission is rendering personal service. If, however, the corporation assumes any such risks as those of market fluctuation, bad debts, failure to accept shipments, etc., or if it guarantees the accounts of the purchaser or is in any way responsible to the seller for the payment of the purchase price, the transaction is one of merchandising or trading and this is true even though the goods are shipped directly from the producer to the consumer and are never actually in the possession of the corporation. The fact that earnings of the corporation are termed commissions or fees is not controlling. The fact that a commission or fee is based on a difference in the prices at which the seller sells and the buyer buys raises a presumption that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary. (Reg. No. 45, Article 1525.)

It will be noted that any agency or brokerage business conducted strictly on the basis of fees or commissions is deemed to be rendering personal service, but that any trading in commodities or the services of others is not rendering personal service. This is hardly consistent because most agency and brokerage businesses use the services of employees, which



would mean that there is a trading in the services of others. The official illustration on page 1224 deals with a corporation which renders engineering services and assumes an income of \$60,000 therefrom. It may reasonably be assumed that the fees paid for services are for the services of others than the principal stockholders. If the use of capital is the fundamental test there is practically no more capital required to pay the salaries of employees than for the salaries or living expenses of the principal stockholders. The language of the statute would seem to be broad enough to include as personal service corporations those who trade in the services of others.

**REGULATION.** It frequently happens that corporations are engaged in two or more professions or businesses which are more or less related, one of which does not consist of rendering personal service. Thus an engineering concern may also engage in contracting, which amounts to trading in materials and labor, a brokerage concern may guarantee some of its accounts, a photographer may sell pictures, frames, art goods and supplies, or a dealer in a commodity may furnish expert advice or services with respect to its installation, use, etc. In such case the corporation is not a personal service corporation unless the non-personal service element is negligible or merely incidental and no appreciable part of its earnings are to be ascribed to such sources. (Reg. No. 45, Article 1526.)

An advertising agency which is incorporated and where the principal owners are personally engaged in the business, but where capital is employed to carry the accounts of customers, would probably be classed as a personal service corporation. In such a case capital would be no more than incidental and would not be a material income-producing factor.

#### • ACTIVITIES OF STOCKHOLDERS OF PERSONAL SERVICE CORPORATIONS.—

**REGULATIONS.** In determining whether a corporation is a personal service corporation, no weight can be given to the fact that it renders personal services unless (a) the principal owners or stockholders are regularly engaged in the active conduct of its affairs and are engaged in such a manner that the earnings are to be ascribed

primarily to their activities, and (b) its affairs are conducted principally by such owners or stockholders. (Reg. No. 45, Article 1527.)

#### CONDUCT OF AFFAIRS.—

Where the principal owners or stockholders do not render the principal part of the services, but merely supervise or direct a force of employees, the corporation is not a personal service corporation. If employees contribute substantially to the services rendered by a corporation, it is not a personal service corporation unless in every case in which services are so rendered the value of and the compensation charged for such services are to be attributed primarily to the experience or skill of the principal owners or stockholders and such fact is evidenced in some definite manner in the normal course of the profession or business. The fact that the principal owners or stockholders give personal attention or render valuable services to the corporation as a result of which its earnings are greater than those of a corporation engaged in a like or similar business, the principal owners or stockholders of which do not devote personal attention to the management or supervision of its affairs, does not of itself constitute the corporation a personal service corporation. (Reg. No. 45, Article 1528.)

#### STOCK INTEREST REQUIRED.—

No definite percentage of stock or interest in the corporation which must be held by those engaged in the active conduct of its affairs in order that they may be deemed to be the principal owners or stockholders can be prescribed as a conclusive test, as other facts may affect any presumption so established. No corporation or its owners or stockholders shall, however, make a return in the first instance on the basis of its being a personal service corporation unless at least 80 per cent of its stock is held by those regularly engaged in the active conduct of its affairs. (Reg. No. 45, Article 1529.)

The regulations do not require that at least 80 per cent of the stock of the corporation must be held by those regularly engaged in the active conduct of its affairs, but does stipulate that unless 80 per cent of the stock is so held the corporation must first make the corporation return and subsequently make application for the privilege of being classed as a personal service corporation.

## CHANGE IN OWNERSHIP.—

The fact that the owners or stockholders of the corporation may change during the course of the taxable year does not take a corporation which is normally in the personal service class out of that class. Frequent changes in the ownership of any substantial interest or number of shares is, however, evidence bearing on the question as to whether the principal owners or stockholders are actively engaged in the conduct of the affairs of the corporation. The incapacity, retirement or death of a principal owner or stockholder who has been actively engaged in the conduct of its affairs will not be deemed to make any change in the status of the corporation during a reasonable time thereafter. (Reg. No. 45, Article 1530.)

## CAPITAL OF PERSONAL SERVICE CORPORATION.—

In determining whether a corporation is a personal service corporation, no weight can be given to the fact that the invested capital of the corporation under title III of the statute or the actual investment of the principal owners or stockholders is comparatively small. The test established by the statute with respect to capital is entirely different. That test is the nature of the profession or business as indicated (a) by the kind of services it renders and (b) the extent to which capital is required to carry on such profession or business. If the use of capital is necessary or more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. No corporation is a personal service corporation if it carries on business of a kind which ordinarily requires the use of capital, irrespective of whether the owners or stockholders have actually invested a substantial amount of capital. (Reg. No. 45, Article 1531.)

The term "capital" as used in Section 200 of the statute . . . . means not only capital actually invested by the owners or stockholders, but also capital secured in other ways. Thus if capital is borrowed either directly as shown by bonds, debentures, certificates of indebtedness, notes, bills payable or other paper, or indirectly as shown by accounts payable or other forms of credit, or if the business of the corporation is in any way financed by or through any of the owners or stockholders, these facts will be deemed evidence that the use of capital is necessary. If a substantial amount of capital is used to finance or carry the accounts of clients or customers, it will be inferred that because of competition or other reasons such practice is necessary in order to secure or hold business which otherwise would be lost, and that the corporation is not a personal service corporation. If a corporation engaged in an agency, brokerage or commission business regularly employs a substantial amount of capital to lend to principals, to buy and

carry goods on its own account, or to buy and carry odd lots in order that it may render more satisfactory service to its principals or customers, it is not a personal service corporation. In general the larger the amount of the capital actually used the stronger is the evidence that capital is necessary and is a material income-producing factor and that the corporation is not a personal service corporation. (Reg. No. 45, Article 1532.)

Generally speaking, the test is not the small amount of capital employed, but the nature of the business as indicated by the kind of services rendered, rather than by the extent to which capital is required. If capital is employed, but is not needed for the conduct of the business, the size of the capital alone would not prevent a corporation from being classed as a personal service corporation.

Page 383

**Computation of tax when corporation is partly a personal service corporation.**—Section 303 provides that if at least 30 per cent of the net income of a corporation is derived from a business, which if constituting its sole business would bring it within the class of personal service corporations, the tax upon that part of the income shall be computed separately. Such a corporation is subject to the excess profits tax and the procedure will be found on page 710. It should be noted on this point, however, that in computing the tax there must be ascribed to the personal service part of the business the same amount of capital which is normally required by the corporations which have been deemed to be personal service corporations and which are not subject to the excess profits tax.

## CHAPTER XVIII

### DEDUCTIONS AND CREDITS—GENERAL

Page 394

**Each year's return must be complete within itself.**—The new regulations are in substantial agreement with former pro-

cedure, but greater stress is laid on the importance of apportioning all of the income and deductions to the period covered by the return. In addition to provisions in Regulations No. 33, which were commented upon on pages 394 and 395, Article III of Regulations No. 45 states that "loss from theft or embezzlement occurring in one year and discovered in another is deductible only for the year of its occurrence." This means, of course, that an amended return may be made for a prior year because the right of the taxpayer to deductions is fully protected by the law itself and, while the regulations very properly lay down methods of procedure, yet the regulations must be reasonable or they cannot be enforced.

## CHAPTER XIX

### DEDUCTIONS FOR EXPENSES

Page 409

**Traveling expenses.**—The regulations continue to hold that hotel bills and similar items which in some cases are living expenses, must not be deducted as business expenses, even though they cover "amounts paid out for expenses for meals and lodging and the like by salesmen, actors and others traveling in the course of their employment."

**REGULATIONS.** Living expenses are in no event allowable deductions even though incurred in the carrying on of business. Amounts paid out for expenses for meals and lodging and the like by salesmen, actors and others traveling in the course of their employment are their living expenses and cannot be deducted from gross income. Amounts which are paid out for expenses incident to services rendered and which are reimbursable are not deductible as expenses, nor are the sums received as reimbursement for them to be returned as income. Any excess of a per diem allowance in lieu of subsistence while under traveling orders over living expenses is taxable income. Amounts paid from a salary received for all services rendered and expenses incurred are deductible as business expenses when the expenditures are occasioned by the services in

respect of which the salary is paid. A salesman who has to pay for the use of a sample room at a hotel for the display of his goods is entitled to deduct such payment as a business expense, and a traveling man or actor is entitled to deduct railroad fares paid to enable him to move about in carrying on his occupation. (Reg. No. 45, Article 292.)

The author repeats the statement on page 410 that in most cases the entire amount expended on a business trip is a business expense. As business expenses are clearly deductible under the law the regulation cannot prevent a taxpayer from claiming all amounts paid out in respect of the earning of income which are not personal, living or family expenses.

**Page 420**

**Pensions to ex-employees.**—As stated on page 420, the 1918 regulations which held that compensation paid to the widow or heirs of an employee does not constitute an allowable deduction, were subject to criticism. The author suggested that notwithstanding the regulations the deduction should be claimed. Article 108, Reg. No. 45, covers the 1919 regulations and holds: "when the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs in recognition of the services rendered by the individual, such payment may be deducted."

**Page 424**

**Charitable contributions.**—Article 251, Reg. No. 45, provides that "a gift of real estate to a city to be maintained perpetually as a public park, is not an allowable deduction." This illustration is used no doubt because it cannot be claimed that a city is a corporation organized and operated exclusively for charitable or similar purposes. The law and Article 251 of Reg. No. 45 specifically provide that contributions are deductible only when made to corporations. On page 425 the author ventured the opinion that the law would be inter-

preted broadly enough to cover contributions to all recognized agencies. On February 28 the Bureau of Internal Revenue made the following statement:

**RULING.** Contributions which may be deducted in computing the net income of an individual taxpayer include not only donations to incorporated institutions, but those given to similar associations which are not incorporated. Contributions to war chest funds, war camp community funds, and similar funds which were raised solely for organizations supporting and furthering war relief, are likewise deductible items on personal returns, within the limit named in the law.

All gifts and donations to churches are deductible, it being held by the Bureau that every church constitutes a religious corporation or association for the purpose of this deduction. Donations to missionary funds, church building funds, or for church activities, which are intended for the furtherance of church work, constitute deductible items.

There can be no departure from the restrictions defined in the law, that the deductibility is limited to contributions to institutions no part of the earnings of which inures to the benefit of any private stockholder or individual, and that the total deduction may not exceed 15 per cent of the taxpayer's net income as computed without the benefit of this deduction.

Individual members of a partnership may include in the deduction for contributions their proportionate shares of such donations made by the partnership.

In each case, however, the limitations defined in the law must be observed.

Page 427

**Donations by corporations.**—The new regulations are substantially the same as the old regulations, except that Article 562 of Reg. No. 45 includes the following: "Expenses incurred in advertising and promoting the sale of Liberty bonds and war savings stamps are deductible. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, and contributions for campaign expenses, are not deductible from gross income."

The provision that the expenses for promoting the sale of Liberty bonds are deductible expenses is hardly in line with the Department's attitude in the past. Article 562, which is a

repetition of former regulations, states that "donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income." It must be assumed, therefore, that expenses in advertising the sale of Liberty bonds contain some measure of benefit flowing to the corporation. At the same time the regulations do not permit as deductions gifts to the Red Cross, Y. M. C. A. or other similar purposes. It would seem that a corporation would reap quite as much benefit by making a contribution to the Red Cross as if it spent a large amount of money in advertising Liberty bonds. In the *New York Times* of March 16, Abraham S. Gilbert, Esq., states that in his opinion a retail establishment would have to contribute to the Red Cross as "absolutely necessary for the life and continued prosperity of the enterprise. No business house could hope to succeed if it were known it had refused to assist in the prosecution of the war by making these contributions." In the opinion of the author, Congress did not intend that a corporation should be permitted to deduct donations such as are referred to above and it cannot be expected that the law will be so administered. The allowance for Liberty bond expenses is probably a matter of expediency rather than a change in policy.

Page 444

**Reserve for trading stamps.**—The 1918 regulations provide that a reserve set up as a liability equal to the redemption value of the stamps issued is not an allowable deduction. Article 104, Reg. No. 45, allows such reserve as a deduction under certain conditions.

**REGULATION.** Where a taxpayer, for the purpose of promoting his business, issues trading stamps or coupons redeemable in merchandise or cash, and sets up a reserve each year to cover all probable redemptions of coupons issued in that year, the reserve so set up may be deducted from gross income as a business expense, pro-



vided: (a) that the returns of the taxpayer are otherwise made on an accrual basis; (b) that any income tax and excess profits tax returns of the taxpayer which have been previously made covering the period since March 1, 1913, shall be amended, if necessary, so that deductions for any of such years are made on the basis of reserves instead of upon actual redemptions as formerly required; and (c) that no larger amount shall be set up as a reserve for any taxable year than would be required for the redemption of such part of the entire issue of that year as it appears will eventually be presented for redemption. The reserve percentage will be determined by considering the experience of the taxpayer and of other users, taking into account any material differences between the taxpayer's situation and that of other users whose experience is relied on. Taxpayers who submit returns on this basis shall file therewith any amended returns called for by this article and shall also attach thereto a statement of the experience of the taxpayer and of any other user of coupons whose experience is relied on to determine the percentage of reserve, indicating the name of such other user, the denominations most largely issued, and the character of business involved in each instance. (Reg. No. 45, Article 104.)

#### Page 445

**Amount paid on judgment.**—Art. III, Reg. No. 45, is in part as follows:

REGULATION. Any amount paid pursuant to a judgment or otherwise on account of damages for personal injuries, patent infringement, or otherwise, is deductible from gross income when the claim is liquidated or put in judgment or actually paid, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequently thereto, however, a taxpayer has for the first time ascertained the amount of a loss sustained during a prior taxable year and not deducted from the gross income therefor, he may render an amended return for such preceding taxable year, including such amount of loss in the deductions from gross income, and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. (Reg. No. 45, Article III.)

The new regulations are very definite in holding that losses which occur in one year and which are not discovered until a later year cannot be deducted in the later year, but are only deductible as of the time when the losses actually occurred. This regulation has some merit, but greater latitude

should have been given to the taxpayer. If in the opinion of the latter "true net income" for the taxable year could be stated by charging the loss as an expense during the taxable year, the taxpayer should not be forced to make amended returns for prior years. The inevitable result will be that for years to come taxpayers will be finding that losses which ordinarily would be charged to current operating accounts, occurred during the years 1918 and 1919 when the tax rates were very high and acting under the letter of the regulations amended returns will be made with a resulting saving in tax.

## CHAPTER XXI

### DEDUCTIONS FOR TAXES

Page 467

**Foreign taxes paid.**—The provision in the 1918 law which permits payment of foreign taxes as deductions from taxes assessed by the United States is a radical departure from former procedure. The following regulations are of interest:

#### MEANING OF TERMS.—

**REGULATIONS.** "Amount of . . . taxes paid during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the individual claiming credit. "Foreign country" means any governmental authority, not that of the United States or any part or possession thereof, having power to impose such taxes, and it therefore includes a self-governing colony, such as the Dominion of Canada. "Any possession of the United States" includes, among others, Porto Rico, the Philippines, and the Virgin Islands. (Reg. No. 45, Article 382.)

#### CONDITIONS OF ALLOWANCE OF CREDIT.—

(a) When credit is sought for income, war profits or excess profits taxes paid other than to the United States, the income tax return of the individual must be accompanied by form 1116, carefully filled out with all the information there called for and with the calculations of credits there indicated, and duly signed and sworn to or affirmed. When credit is sought for taxes already paid the form

must have attached to it the receipt for each such tax payment. When credit is sought for taxes accrued the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original or a duly certified or authenticated copy. (b) In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to form 1116. If such a bond is required, form 1117 shall be used for it. It shall be in such penal sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, his agent or representative, as principal, and by sureties satisfactory to and approved by the Commissioner. (Reg. No. 45, Article 383.)

**REDETERMINATION OF TAX WHEN CREDIT PROVES INCORRECT.—**

In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount of the income tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such redetermination to have been overpaid shall be credited against any income, war profits or excess profits taxes, or installment thereof, then due from such taxpayer under any other return, and any balance of such amount shall be immediately refunded to him. (Reg. No. 45, Article 384.)

In addition to the foregoing, Article 611 requires that form 1118 must be used for claiming credit and form 1119 must be used for the bond if a bond be required.

Page 471

**Stamp and other taxes deductible.**—The regulations are in accord with the comments on pages 471 and 472. The fol-

lowing extracts from Article 131, Reg. No. 45, are of interest: "Postage is not a tax. Amounts paid to states under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinarily taxes."

**Page 475**

**Special assessments may or may not be deductible.**—The comments on the new provision in the 1918 law, which appear on pages 475 and 476, are borne out by the regulations, except that Article 133, Reg. No. 45, excludes the deduction for the payment of certain assessments unless held to be necessary to the conduct of the business of the taxpayer. In the opinion of the author this regulation conflicts with the law. The special assessments referred to are made by municipal authorities and are of the exact category as most local taxes. The law expressly permits the deduction of all taxes paid unless they tend to increase the value of the property assessed. If for maintenance or repair, as stated in Article 133, the assessments certainly do not increase the value of the property and therefore the deduction must be permitted the same as all items of taxes are deductible. The Department cannot refuse to allow the deductions unless it can be shown that the taxes assessed are of a kind tending to increase the value of the property. The article is reproduced in full but in the opinion of the author cannot be sustained.

**TAXES FOR LOCAL BENEFITS.—**

**REGULATION.** So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income. A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under Illinois laws relating to drainage districts are not limited to

the property benefited, and assessments so paid are deductible. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and amounts so paid are not deductible as taxes. When assessments are made for the purpose of maintenance or repair of local benefits, the taxpayer may deduct the assessments paid as an expense incurred in business, if the payment of such assessments is necessary to the conduct of his business. Where the assessments are made for the purpose of constructing local benefits, the payments by the taxpayer are in the nature of capital expenditures and are not deductible. Where assessments are made for the purpose of both construction and maintenance or repairs, the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation cannot be made, none of the amounts so paid is deductible. (Reg. No. 45, Article 133.)

Page 480

**Collateral inheritance tax.**—Article 134, Reg. No. 45, broadens former regulations on the non-deductibility of inheritance taxes. The new regulation is as follows:

REGULATION. State inheritance taxes paid by the executor or administrator of an estate of a deceased person, which are provided by law to be deducted from the respective legacies or distributive shares, are not allowable deductions in computing the net income of such estate subject to tax, even though the will contain a direction to pay inheritance taxes out of the residue. An inheritance tax is upon the transfer of the property and not upon the estate of the decedent or upon the executor or administrator, although the latter is required to pay it. In general, taxes paid or accrued within the year imposed by the authority of any state, or otherwise, are limited to those imposed upon the taxpayer and do not include taxes paid by him on behalf of another, even though he is required by law to make such payment. Since, moreover, the tax is imposed upon the transfer before the property reaches the legatee or distributee, and merely diminishes the capital share of the estate received by him, such tax is not imposed upon the legatee or distributee and is not an allowable deduction from his income. (Reg. No. 45, Article 134.)

## CHAPTER XXII

## DEDUCTIONS FOR LOSSES

Page 486

**Deductions for losses.**—It appears that since the publication of form 1040 many taxpayers have arrived at an erroneous conclusion in connection with the arrangement on page 2 of return. Block J indicates the net income on which normal tax is to be calculated. To that item the total of block K (a) and (b) (dividends and certain interest) are to be added, thus arriving at the total subject to surtax (block L). In very many instances during 1918 losses exceeded taxable income from sources other than dividends, so that a taxpayer, having entered all income except from dividends and having entered all losses, might find that the total under block J would be a net loss. To an accountant this would be a very simple problem, as he would merely enter the net loss in red ink. Then when the totals of blocks K (a) and K (b) were entered, if the latter were greater than the net loss as shown by block J, the amount shown on block L would represent the net taxable income. From statements to the author it would appear that many taxpayers have believed that if their losses exceeded their net income from sources other than dividends, they were not entitled to enter any amount whatever on block J, owing to the form of the return, and thus dividends would be taxable at the surtax rates without any deduction for the net loss incurred from all other sources.

The point could easily have been covered if to block J there had been added the words "net loss" as well as net income.

Page 486

**Net losses sustained in 1918 by certain taxpayers.**—The new regulations do not extend the relief which Section 204

(b) is supposed to provide for beyond the limited class mentioned in the law itself. On the contrary Article 1601 of Reg. No. 45 states:

SCOPE OF NET LOSSES.—

REGULATIONS. As used in the statute the term "net loss" means either a business operating loss or a loss realized by a bona fide sale of property constructed, installed or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war. The amount of net loss claimed must represent an actual net loss over and above all income, including tax-free income. Such losses will be allowable only in respect of a taxpayer having a taxable year beginning after October 31, 1918, and ending prior to January 1, 1920, and after one claim has been allowed no further claim can be considered. (Reg. No. 45, Article 1601.)

CLAIM FOR ALLOWANCE OF NET LOSS.—

A taxpayer having such a net loss may file a claim with the collector of the district in which the taxpayer's return for the preceding year was filed. Such claim should state the name and address of the taxpayer and should contain a concise statement of the amount of the loss sustained and the basis upon which it has been computed, together with all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim. Each claim should be supported by an affidavit. (Reg. No. 45, Article 1602.)

ALLOWANCE OF NET LOSS.—

The amount allowed by the Commissioner in respect of any such claim shall be deducted from the net income for the taxable year 1918, and the taxes imposed by this title shall be recomputed accordingly. Any amount found to be due him shall be credited or refunded to the taxpayer in accordance with the provisions of Section 252. In any case in which it is found by the Commissioner that such net loss is in excess of the net income of such preceding taxable year, the taxpayer may carry forward the amount of such excess and claim it as a deduction in computing net income for the succeeding taxable year. (Reg. No. 45, Article 1603.)

## RECOMPUTATION OF TAX BY CORPORATION WHICH ESTABLISHES A NET LOSS FOR

PAGES

FISCAL YEAR ENDING NOVEMBER 30, 1919

FORM 1120  
SCHEDULE & ITEM  
I-7

Net Income for taxable year ended November 30, 1918..... \$500,000

Tax was computed as follows:

UNDER 1917 LAW:

Invested Capital .....	\$1,000,000
Exemption 9% .....	\$90,000
Specific .....	3,000
	<u>\$93,000</u>

	AMOUNT TAXABLE	TAX
15% of Invested Capital \$150,000 less Cr. \$93,000	\$57,000 at 20% =	\$11,400
15-20% " " 50,000	50,000 at 25% =	12,500
20-25% " " 50,000	50,000 at 35% =	17,500
25-33% " " 80,000	80,000 at 45% =	36,000
Above 33% " " 170,000	170,000 at 60% =	102,000

Total Net Income	<u>\$500,000</u>
------------------	------------------

Excess Profits Tax .....	\$179,400
Net Income .....	500,000

Subject to Income Tax.....	<u>\$320,600</u>
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6% .....	\$19,236
Add: Excess Profits Tax.....	179,400

Total Tax at 1917 rates.....	<u>\$198,636</u>
------------------------------	------------------

Of which applicable to 1917 is 1/12 = .....	<u>\$16,553</u>
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IV - 22



714 - 715	UNDER 1918 LAW: War Profits Credit: 10% of Invested Capital..... Specific .....	\$100,000 3,000	IV - 5
706	Net Income .....	500,000	IV - 4
	Subject to War Profits Tax.....	\$397,000	IV - 6
	At 80% = .....	\$317,600	IV - 14
52	Net Income .....	\$500,000	IV - 12
	Less: War Profits Tax.....	319,600	IV - 14
	Exemption .....		IV - 15
115	At 12% = .....	\$180,400	IV - 16
	Add: War Profits Tax.....	\$21,648	IV - 17
	Total Tax at 1918 rates.....	317,600	
699	Of which applicable to 1918 11/12 = .....	\$339,248	
	Applicable to 1917, as above.....	\$310,977	IV - 21
	Total Tax paid.....	16,553	IV - 22
486 - 488	Net Income 1918.....	\$327,530	IV - 25
	Deduct: Net loss year ending November 30, 1919 .....	\$500,000	
	Revised Income for taxable year 1918.....	100,000	
		\$400,000	I - 7

FORM 1120  
SCHEDULE & ITEM

PAGES	UNDER 1917 LAW:		
	Total Tax .....		\$198,636
486	Loss to be deducted .....	\$100,000	
794	All in 60% bracket .....	60,000	
	Subject to Normal Tax .....	<u>\$40,000</u>	
115	Normal Tax at 6% = .....	<u>\$2,400</u>	
	Excess Profits Tax as above .....	60,000	
	Total Tax to be deducted .....		62,400
	Adjusted Tax .....	<u>\$136,236</u>	
699	Of which applicable to 1917 is 1/12 .....	<u>\$11,353</u>	IV - 22
	UNDER 1918 LAW:		
	Total Tax .....		\$339,248
486	Loss to be deducted .....	\$100,000	
766	All at 80% .....	80,000	
	Subject to Normal Tax .....	<u>\$20,000</u>	
115	Normal Tax at 12% = .....	<u>\$2,400</u>	
	Excess Profits Tax as above .....	80,000	
	Adjusted Tax .....		82,400
	Of which applicable to 1918 is 11/12 = .....	<u>\$256,848</u>	
699	Applicable to 1917 .....	<u>\$235,444</u>	IV - 21
	Total Tax .....	11,353	IV - 22
	Tax paid .....	\$246,797	
	To be refunded .....	327,530	
		<u>\$80,733</u>	

**Losses due to inventory shrinkage.**—The new regulations are as follows:

**REGULATION.** Losses under this paragraph relate only to a re-determination of the value of inventories taken at the close of the taxable year 1918. Such redetermination of value may be made (a) before the date of filing a return for that year, in which case the claim should be filed with the return, or (b) if no such claim is filed with the return; a claim may be filed subsequently thereto with the collector. Each claim should state the name and address of the taxpayer and should contain a concise statement of the amount of the loss sustained and the basis upon which it has been computed, together with all pertinent facts necessary to enable the Commissioner to determine the allowability of the claim. Each claim should be supported by an affidavit, and after one claim has been allowed no further claim can be considered. To be allowed such inventory loss must be substantial in amount and represent either (a) a realization by sale of goods taken in the inventory or (b) a shrinkage in market price (and such shrinkage must show sound evidence of permanency) of goods taken in the inventory and unsold at the date of the claim. In determining whether a loss has been realized by the sale of goods taken in the inventory, all sales made subsequent to the date of the inventory will be deemed to have been made from the inventoried stock until such inventoried stock is exhausted. No claim will be allowed for any loss of anticipated profits. Claims may also be made for a deduction from income of the taxable year 1918 of the amounts of payments actually made after the close of such taxable year on account of rebates in pursuance of contracts entered into during such year upon sales made during such year. In any case where payment of the tax has not been made prior to the filing of the claim no such payment shall be required upon the income covered by such claim until the claim is decided, but in such case the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due. If any part of such claim is disallowed, then the remainder of the tax due shall bear interest at the rate of one per cent per month from the time the tax would have been due had no such claim been filed. The amount allowed by the Commissioner in respect of any such claim shall be deducted from the net income for the taxable year 1918, and the taxes shall be recomputed accordingly and the excess of tax due, if any, shall be credited or refunded to the taxpayer. In computing income for the taxable year 1919, the opening inventory must be properly adjusted by the

taxpayer in respect of any claim allowed for the year 1918 under this article. Goods taken in the inventory which have been so intermingled that they cannot be identified with specific invoices will be deemed to be the goods most recently purchased. (Reg. No. 45, Article 261.)

It should be noted that the Department will not entertain a claim after one claim has been allowed. Therefore the option of claiming shrinkage at time of filing the return would preclude another claim for loss later in the year. This is a reasonable requirement and would seem to accord with the law as sub-section (b) (page 489) provides that "if no such claim is filed" the tax may be redetermined, etc. This practically gives the taxpayer whose year ended December 31, 1918, until April 29, 1919, to decide whether or not a claim for shrinkage shall be made at once or deferred. Where conditions are unsettled and the trend of the market is downward, it would seem wise to postpone the claim for shrinkage until a trustworthy statement can be made.

#### Page 493

**Losses in illegal transactions are not deductible.**—The Department takes the position that profits arising out of illegal transactions are taxable, but Article 141, Reg. No. 45, holds that "losses in illegal transactions are not deductible." Section 214 (a-5) specifically permits the deduction of all losses if incurred in "any transaction entered into for profit."

As stated on page 218, recent federal laws have omitted the word "lawful" and income from gambling transactions is unquestionably taxable. If a taxpayer enters into an illegal transaction he naturally hopes to make a profit out of it. If such profit is realized it is taxable. If it results in a loss, under the law it would seem to be an allowable deduction. The law does not say "any lawful transaction" but does say "any transaction."

**Shrinkage in value of securities.**—The Department continues to hold that the taxpayer cannot claim as a loss any shrinkage in value “through fluctuations of the market or otherwise,” but this decision is considerably modified by the following statement in Article 144 of Reg. No. 45: “If stock of a corporation becomes worthless, its cost . . . may be deducted by the owner . . . provided a satisfactory showing of its worthlessness be made as in the case of bad debts.”

Heretofore when a taxpayer has had worthless stocks he has been compelled to go through the farce of selling them to someone for a dollar before the loss could be deducted. The new ruling is a great improvement.

**REGULATION.** A person possessing securities, such as stocks and bonds, cannot deduct from gross income any amount claimed as a loss on account of the shrinkage in value of such securities through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the securities mature or are disposed of. In the case of banks or other corporations which are subject to supervision by state or federal authorities, and which in obedience to the orders of such supervisory officers charge off as losses amounts representing an alleged shrinkage in the value of property, the amounts so charged off do not constitute allowable deductions. The foregoing applies only to owners and investors, and not to dealers in securities. . . . However, if stock of a corporation becomes worthless, its cost or its fair market value as of March 1, 1913, if acquired prior thereto, may be deducted by the owner in the taxable year in which the stock was ascertained to be worthless and charged off, provided a satisfactory showing of its worthlessness be made as in the case of bad debts. (Reg. No. 45, Article 144.)

**LOSSES ON SALES OF SECURITIES.**—When securities of the same issue, which were bought at different prices, are sold at a loss, the basis for determining the loss will be found on page 265.

**Losses sustained by individuals.**—In his comments on page 501 the author states that the loss must be a net loss,

that is, the actual money loss sustained by the taxpayer. This was not intended to mean that the taxpayer could not deduct a loss based upon a revaluation. This point is covered on page 495. The point may be further amplified in the case where the recipient of a gift or the beneficiary of an estate subsequently sells stocks, bonds or any kind of property at a price less than the fair market or appraised price at the time the gift is received. The measure of deduction is based entirely upon the valuation at the time the property changes hands and the loss is just as much deductible by the recipient of the gift as if the recipient had paid in cash the amount of the appraised value. This rule, of course, is subject to a general rule that depreciation through wear and tear must be always taken into consideration. If a taxpayer inherits a house (which he occupies as a residence), which is appraised at \$10,000 and sells it the following year for \$8,000, it may be assumed that the deductible loss will be something less than \$2,000, as the depreciation during the year is held to be a personal expense, which is not deductible.

#### Page 502

**Individuals' share of corporation losses.**—When a corporation reduces its capital stock because large net losses have been sustained, stockholders are entitled to claim as a loss the difference between the cost or value March 1, 1913, of the old stock and the fair market value of the new stock received. It might be urged that this is not a closed transaction and that it is in effect merely a shrinkage in value. This, however, is not the case, because the corporation has legally determined its loss and as to the shares of old stock the transaction is a completed one. The new shares represent an ownership in different assets which meets the Department's requirements that there must be a change in substance and not merely in form.

## CHAPTER XXIII

## DEDUCTIONS FOR BAD DEBTS

Page 522

**Bankruptcy as a test.**—The new regulations more nearly accord with business practice than has been the case with the old regulations. Heretofore it has been held that actual determination of worthlessness in bankruptcy cases is only possible when settlements shall have been had. The new regulations hold that “actual determination of worthlessness in such a case is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had.”

**BAD DEBTS.**—

**REGULATION.** Accounts merely written down and debts recognized as worthless prior to the beginning of the taxable year are not deductible. Where all the surrounding and attendant circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy may or may not be an indication of the worthlessness of a debt, and actual determination of worthlessness in such a case is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year confirming the conclusion that the debt is worthless will not authorize shifting the deduction to such later year. In the case of debts existing prior to March 1, 1913, only their value on that date may be deducted upon subsequently ascertaining them to be worthless. (Reg. No. 45, Article 151.)

## CHAPTER XXIV

## DEDUCTIONS FOR DEPRECIATION

Page 535

**Depreciation of residence.**—When a residence is used part of the year by the owner and is rented for part of the year, depreciation will be an allowable deduction for the period of the year when used for income producing purposes. The depreciation is not necessarily based on the proportion of time during which the property is rented, as the actual depreciation during such time may be greater than during the time of occupancy by the owner. If the taxpayer owns a summer cottage and rents it for three months during the summer and occupies it personally during one month, it may be that the entire annual depreciation should be deducted as the facts would indicate that the property as a whole is held for income-producing purposes and the occupancy by the owner for a short period is merely incidental. The test, however, would be the actual circumstances in each case.

Page 541

**Depreciation must be entered upon the books of a corporation.**—The new regulations are of interest because the 1918 law does not specify that depreciation must be charged off, but as the Commissioner has the power to require taxpayers to keep proper records, the following regulation can be considered as having all the effect of law.

**CHARGING OFF DEPRECIATION.**—

**REGULATION.** A depreciation allowance, in order to constitute an allowable deduction from gross income, must be charged off. The particular manner in which it shall be charged off is not material, except that the amount measuring a reasonable allowance for depreciation must be either deducted directly from the book value of the assets or preferably credited to a depreciation reserve account, which must be reflected in the annual balance sheet. The allowances



should be computed and charged off with express reference to specific items, units or groups of property, each item or unit being considered separately or specifically included in a group with others to which the same factors apply. The taxpayer should keep such records as to each item or unit of depreciable property as will permit the ready verification of the factors used in computing the allowance for each year for each item, unit or group. (Reg. No. 45, Article 170.)

**Page 547**

**Depreciation in cases of permanent discontinuance.**—The new regulations cover a procedure which should be followed upon the permanent discontinuance of the use of property even though no sale or other disposition is made.

**CLOSING DEPRECIATION ACCOUNT AS TO ANY ITEM.**—

**REGULATION.** If the use of the property in the business is permanently discontinued, although no sale or other disposition of the property has been made, a determination of any gain or loss may be made; but any deduction in respect of any loss thereon must be disclosed in the taxpayer's return for the year in which the determination is made and a full statement of the facts and the basis upon which the computation is calculated must be attached to the return. Upon a sale or other disposition of the property, the consideration received shall be compared with the amount of the estimated salvage value used in computing the gain or loss as above provided, and the amount of the difference shall be treated as a gain or loss, as the case may be, of the year in which the sale or other disposition was made. (Reg. No. 45, Article 171.)

**Page 550**

**Rates of depreciation—general.**—Following former practice, the Department makes no attempt to fix specific rates of depreciation. The new regulations confirm this attitude.

**METHOD OF COMPUTING DEPRECIATION ALLOWANCE.**—

**REGULATION.** The capital sum to be replaced should be charged off over the useful life of the property either in equal annual instalments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and should be described in the return. (Reg. No. 45, Article 166.)

## Page 565

**Depreciation of intangible property.**—As stated elsewhere, the Department now recognizes the position the author has held for several years, viz., that any kind of property, tangible or intangible, may be amortized, depreciated or depleted either on the basis of market value at March 1, 1913, or upon cost since that time.

**REGULATION.** Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, and limited leases, licenses, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. For example, there can be no such allowance in respect of goodwill, trade-names, trade-marks, trade-brands, secret formulae or processes. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. (Reg. No. 45, Article 163.)

The foregoing regulation is quite as liberal as could be desired. Leases are specifically provided for and on the same principle contracts would also be covered. If an automobile dealer secures a valuable contract from a manufacturer, and turns it over to a corporation, the latter may claim as a deduction the cost of the contract spread over its life, but in this case as in all other similar cases the corporation cannot claim the deduction unless the payment for the contract was made in good faith and for proper consideration, and where there was any community of interest between the dealer and the company the former would be compelled to return as taxable income the purchase price of the contract received by him from the corporation.

## Page 572

**Patents.**—The following regulation is of interest. It will be noted that the taxpayer may elect not to take a deprecia-

tion allowance for patents. In view, however, of the limitation of the value of patents in connection with invested capital, the permission would seem to be of doubtful value in most cases. Generally speaking, conservative business methods require the charging off of intangibles as quickly as possible.

#### DEPRECIATION ALLOWANCE FOR PATENT.—

**REGULATION.** In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost (not already deducted as current expense) of the patent or copyright or its fair market value as of March 1, 1913, if acquired prior thereto. The allowance should be computed by an apportionment of the cost of the patent or copyright or of its fair market value as of March 1, 1913, over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be. If the patent or copyright was acquired from the government, its cost consists of the various government fees, cost of drawings, experimental models, attorney's fees, etc., actually paid. A taxpayer may elect not to take a depreciation allowance for patents, but such election if made is final and will control the returns for all subsequent years. (Reg. No. 45, Article 168.)

It should be noted that the Department now specifically permits the depreciation of a patent based on its value as of March 1, 1913. Reg. No. 33, 1918, referred to on page 573, specifically disallowed such revaluation.

Page 573

**Patterns, drawings, etc.**—Previous regulations have required that expenditures for patterns, etc., must be capitalized and specifically written off based on their effective life. The new regulations give to the taxpayer the option of charging off such items as an expense or capitalizing them.

#### DEPRECIATION OF DRAWINGS AND MODELS.—

**REGULATION.** A taxpayer who has incurred expenses in his business for designs, drawings, patterns, models, or work of an experimental nature calculated to result in improvement of his facilities or his product, may at his option deduct such expenses from gross income for the taxable year in which they are incurred or treat such articles as a capital asset to the extent of the amount so expended. In the latter case, if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of

depreciation allowances spread over such estimated period of usefulness. The facts must be fully shown in the return or prior thereto to the satisfaction of the Commissioner. Except for such depreciation allowances no deduction shall be made by the taxpayer against any sum so set up as an asset except on the sale or other disposition of such assets at a loss or on proof of a total loss thereof. (Reg. No. 45, Article 169.)

## CHAPTER XXV

### DEDUCTIONS FOR OBSOLESCENCE AND AMORTIZATION

Page 581

**Obsolescence.**—The Department has always allowed as deductions realized obsolescence. As such deductions could have been made whether or not obsolescence as such was provided for in the law, there would seem to be some good reason for the specific mention of obsolescence in the 1918 law. It was generally supposed that the new regulations would provide for reserves for obsolescence as well as reserves for depreciation. Article 167, which contains directions for computing depreciation, has this provision: "A taxpayer who in computing depreciation allowances in returns for years prior to 1918 has not taken ordinary obsolescence into consideration, may for the year 1918 and subsequent years, revise the estimate of the useful life of any property so as to allow for such future obsolescence as may be expected from experience to result from the normal progress of the art."

The foregoing would indicate that the Department expects that so-called "ordinary obsolescence" shall be included in the annual depreciation allowances rather than in a specific reserve for obsolescence. This accords with proper accounting methods. As stated by the author on page 582, commenting on past procedure, as obsolescence is a factor in depreciation, "it follows that in fact deductions were made for

obsolescence." The law now definitely sanctions the deductions which taxpayers have been making and which the Treasury Department has been allowing for some years.

**EXTRAORDINARY OBsolescence.**—The foregoing, however, relates to so-called "ordinary obsolescence." The regulation as to extraordinary obsolescence is as follows:

**REGULATION.** When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or value as of March 1, 1913, of any asset so discarded (less any depreciation allowances) and its salvage value remaining. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where machinery or other property must be replaced by a new invention, or where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. This article is not intended to cover cases calling for the application of Articles 181-187. (Reg. No. 45, Article 143.)

Page 585

**Amortization of plant.**—The new regulations covering amortization are as follows:

**PROPERTY THE COST OF WHICH MAY BE AMORTIZED.**—

**REGULATION.** The taxpayer may make a reasonable deduction from gross income not in excess of a sum sufficient to extinguish the cost of buildings, machinery, equipment, or other facilities con-

structed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of the present war. A deduction on account of amortization will be allowed only in the case of enterprises or projects falling within the class of activities contributing to the prosecution of the present war. (Reg. No. 45, Article 181.)

**COST WHICH MAY BE AMORTIZED.—**

The total amount to be extinguished by amortization is the difference between the original cost to the taxpayer of the property and its value to the taxpayer at the close of the amortization period (a) for sale or (b) for use, immediate or prospective, as part of the plant or equipment of a going business, whichever value is the larger, less any amounts otherwise deducted or deductible for wear, tear, obsolescence and loss. In the case of property the construction or installation of which was commenced before April 6, 1917, and completed subsequently to that date, amortization will be allowed with respect only to the cost incurred on or after April 6, 1917. (Reg. No. 45, Article 182.)

It should be noted that the total amount to be amortized is the difference between the cost of the property, and its value at the close of the period. If sold, or held for sale at a specific price, there will be no difficulty about the valuation. If the taxpayer proposes to use the plant immediately or prospectively as a going business, the basis of valuation is laid down on page 586. The regulations require that when the value of the property for sale is greater than its value for the use of the taxpayer, the latter value must be disregarded and allowance for amortization can only be claimed on the basis of the sales value. This is reasonable. If the war plant of a taxpayer can be sold for \$500,000 but the taxpayer thinks that to him it is worth only \$400,000, a claim for amortization based on the \$400,000 valuation would be unreasonable and improper. On the other hand, the only sales price with which the taxpayer need concern himself is that based upon a bona fide offer to buy. The mere fact that the taxpayer asked \$500,000 for his plant would not have stopped him from later writing down its value on his books to \$400,-

000. It would have to be shown that someone was willing to pay the \$500,000. The valuation for prospective use must also be determined upon a reasonable basis. The taxpayer may hope to have some profitable use for a war plant at some future time, but he would not be bound by the valuation which such plant might represent to him prospectively. If, however, there is a prospective use which is definite enough to be translated into a revaluation of the plant to be used for such purposes, then excessive amortization should not be claimed. Necessarily much is left to the good faith of the taxpayer. In fixing values it must be borne in mind that the Commissioner may at any time within three years require an appraisal and redetermination of the tax. If such appraisal indicates an excessive claim for amortization greater than that which a reasonable or diligent man would have claimed, the taxpayer will, no doubt, be subject to the penalties provided for when an understatement is made in the returns.

The regulation does not provide for the case of any property installed prior to April 6, 1917, but when construction was commenced before that date and completed subsequently all that part completed after April 6 may be amortized.

#### AMORTIZATION PERIOD.—

REGULATIONS. The period over which the deduction allowed is to be spread, or during which it is to be amortized, is the estimated period between the date of acquisition or completion of the property and the date upon which either (a) the property will become useless or (b) the taxpayer will be able to earn by operation or use a normal return upon the unamortized cost, whichever date is the earlier. (Reg. No. 45, Article 183.)

#### METHOD OF AMORTIZATION.—

The proportion of allowable deduction to be allocated to each taxable year of the amortization period will be, as nearly as may be determined, the same proportion which the net income or profit derived during such taxable year bears to the entire net income or profit derived during the amortization period from the operation or use of such property. (Reg. No. 45, Article 184.)

## ADDITIONAL REQUIREMENTS FOR AMORTIZATION.—

Claims for amortization must be unmistakably differentiated in the return from all other claims for wear, tear, obsolescence and loss. No such claim will be allowed unless it is reflected in any accounts submitted by the taxpayer to stockholders and in any credit statements by the taxpayer to banks, and is given full effect on his financial books of account. If government or other contracts taken by the taxpayer contained recognition of amortization as an element in the cost of production, copies of such contracts shall be filed with the taxpayer's return, together with a statement and description of any sums received on account of amortization and the basis upon which they were determined. In any case in which an allowance has been made for amortization of cost the taxpayer will not be allowed to restore to his invested capital for the purpose of the war profits and excess profits tax any portion of the amount covered by such allowance. (Reg. No. 45, Article 185.)

## REDETERMINATION OF AMORTIZATION ALLOWANCE.—

Redetermination of the deduction allowed on account of amortization may, or at the request of the taxpayer shall, be made by the Commissioner at any time within three years after the termination of the present war, and if as a result of an appraisal or from other evidence it is found that the deduction originally allowed was incorrect, the amount of tax due for each taxable year during the amortization period will be adjusted by additional assessment or by refund. (Reg. No. 45, Article 186.)

## INFORMATION TO BE FURNISHED BY TAXPAYER.—

To obtain the benefit of this provision of the statute the taxpayer must establish to the satisfaction of the Commissioner that the entire deduction claimed and the proportion claimed for any particular year are reasonable. The taxpayer shall also submit a supplementary statement setting forth the following information: (a) a description of the property in reasonable detail; (b) the date or dates on which the property was acquired, and from whom, or, if constructed, erected, or installed by the taxpayer, the dates on which such construction, erection, or installation was begun and completed; (c) evidence establishing the intention of the taxpayer on and after April 6, 1917, or on and after the date of acquisition or the date of beginning construction, erection or installation, to devote such property or vessels to the production of articles (or, in the case of vessels, the transportation of articles or men) contributing to the prosecution of the present war; (d) the cost of construction, erection, installation or acquisition; (e) the value of the property after termination of the amortization period; (f) a segre-



gation of property which will have no value (except for salvage) following the amortization period, and of property which will have value after such period for use in a going concern or business; (g) all deductions from gross income otherwise taken or claimed with respect to such property; (h) the computation by which the total amount to be extinguished by amortization was determined; and (i) the computation by which the proportion of the amortization charge claimed as deduction in the taxable year for which return is being made was determined. (Reg. No. 45, Article 187.)

## CHAPTER XXVI

### DEDUCTIONS FOR DEPLETION

Page 591

**Basis for depletion of property acquired before March 1, 1913.**—The new regulations contain enough changes to warrant reproduction in full.

#### DEPLETION OF MINES, OIL AND GAS WELLS.—

**REGULATIONS.** A reasonable deduction from gross income for the depletion of natural deposits and for the depreciation of improvements is permitted, based (a) upon cost, if acquired after February 28, 1913, or (b) upon the fair market value as of March 1, 1913, if acquired prior thereto, or (c) upon the fair market value within 30 days after the date of discovery in the case of mines, oil and gas wells discovered by the taxpayer after February 28, 1913, where the fair market value is materially disproportionate to the cost. The essence of this provision is that the owner of such property, whether it be a leasehold or freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to the fair market value as of March 1, 1913, of the properties owned prior to that date, or an amount equal to the fair market value within 30 days after the date of discovery of mines, oil or gas wells discovered by the taxpayer on or after March 1, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost; plus in any case the subsequent cost of plant and equipment (less salvage value), and underground and overground development, which is not chargeable to current operating expense, but not including land values for purposes other than the extraction of minerals. Operating owners, lessors, and lessees

are entitled to deduct an allowance for depletion, but a stockholder in a mining or oil or gas corporation is not. (Reg. No. 45, Article 201.)

#### DETERMINATION OF COST OF DEPOSITS.—

In any case in which a depletion or depreciation deduction is computed on the basis of the cost or price at which any mine, mineral deposit, mineral rights, or leasehold was acquired, the owner or lessee will be required upon request of the Commissioner to show that the cost or price at which the property was bought was fixed for the purpose of a bona fide purchase and sale, by which the property passed to an owner, in fact as well as in form, different from the vendor. No fictitious or inflated cost or price will be permitted to form the basis of any calculation of a depletion or depreciation deduction, and in determining whether or not the price or cost at which any purchase or sale was made represented the actual market value of the property sold, due weight will be given to the relationship or connection existing between the person selling the property and the buyer thereof. (Reg. No. 45, Article 205.)

#### DETERMINATION OF FAIR MARKET VALUE OF DEPOSITS.—

Where the fair market value of the property at a specified date in lieu of the cost thereof is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or in methods of mining or extraction. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. No rule or method of determining the fair market value of mineral property is prescribed, but the Commissioner will lend due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purposes of the capital stock tax, valuation for local or state taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, disinterested appraisals by approved methods, and other factors. (Reg. No. 45, Article 206.)

#### REVALUATION OF DEPOSITS NOT ALLOWED.—

The cost of the property or its fair market value at a specified

date, as the case may be, plus subsequent charges to capital account not deductible as current expense, will be the basis for determining the depletion and depreciation deductions for each year during the continuance of the ownership under which the fair market value or cost was fixed, and during such ownership there can be no revaluation for the purpose of this deduction. This rule will not forbid the redistribution of the capital account over the estimated number of units remaining in the property in accordance with either of the next two articles. (Reg. No. 45, Article 207.)

COMPUTATION OF ALLOWANCE FOR DEPLETION OF MINES  
AND OIL WELLS.—

When the cost or value as of March 1, 1913, or within 30 days after the date of discovery of the property shall have been determined, and the number of mineral units in the property as of the date of acquisition or valuation shall have been estimated, the division of the former amount by the latter figure will give the unit value for purposes of depletion, and the depletion allowance for the taxable year may be computed by multiplying such unit value by the number of units of mineral extracted during the year. If, however, proper additions are made to the capital account represented by the original cost or value of the property, or unforeseen extraordinary circumstances necessitate a revised estimate of the number of mineral units in the ground, a new unit value for purposes of depletion may be found by dividing the capital account at the end of the year, less deductions for depletion to the beginning of the taxable year which have or should have been taken, by the number of units in the ground at the beginning of the taxable year. This number, unless a revision of the original estimate has been necessary, will equal the number of units in the ground at the date of original acquisition or valuation less the number extracted prior to the taxable year. If, however, a recalculation is needed, the number of units at the beginning of the year will be the sum of the gross production of the year and the estimated mineral reserves in the property at the end of the year. (Reg. No. 45, Article 210.)

Page 593

**Depletion allowances to lessors.**—It will be noted from Reg. No. 45, Article 201 (pages 1148 and 1149) that a stockholder in a mining or oil or gas corporation is not entitled to any allowance for depletion, as the depletion claimed by and allowed to the corporation exhausts the allowable deduction.

## Page 593

**Depletion allowances to lessees.**—On pages 567 and 568 will be found a full discussion of the deductions that may be taken by lessees in connection with buildings, land, etc. The following comments relate solely to the deductions which may be taken by the lessees of natural resources such as minerals, oil, timber, etc. It will be noted that the new regulations substantiate the statement of the author on page 593 that the fair value of leaseholds established as of March 1, 1913, is the proper basis for a lessee to use in determining depletion allowances.

**CAPITAL RECOVERABLE THROUGH DEPLETION ALLOWANCE IN THE CASE OF LESSEE.**—

**REGULATIONS.** In the case of a lessee the capital remaining in any year recoverable through depletion allowances is the sum of (a) the cost of the leasehold, or its fair market value as of March 1, 1913, or its fair market value within 30 days after discovery, as the case may be, plus (b) the cost of subsequent improvements and development not charged to current operating expenses, but minus (c) deductions for depletion which have or should have been taken to date, and (d) the portion of the capital account, if any, as to which depreciation has been and is being deducted instead of depletion. Any annual or periodical rents or royalties supplementing the bonus or other amount paid for the lease may be charged to current operating expenses or to capital account, and in the latter event will form part of the capital returnable through deductions for depletion. (Reg. No. 45, Article 203.)

**APPORTIONMENT OF DEDUCTIONS BETWEEN LESSOR AND LESSEE.**—

As the value of property comprehends the interests of both lessor and lessee, no computation, for the purpose of depletion allowances, of the value of these interests separately as of any date which combined exceeds the value of the property in fee simple will be permitted. The same principle applies to holders of fractional interests. If the aggregate deduction claimed is deemed excessive, the Commissioner may request the owner or lessee to show that the valuation claimed does not exceed the fair market value of the property at a specified date determined in the manner explained in Article

206. The lessor and lessee shall, with the approval of the Commissioner, equitably apportion the allowance in the light of the peculiar conditions in each case and on the basis of their respective interests therein. To the return of every taxpayer claiming an allowance for depletion in respect of (a) property in which he owns a fractional interest only or (b) a leasehold or (c) property subject to a lease, there shall be attached a statement setting forth the name and address and the precise nature of the holdings of each person interested in the property. (Reg. No. 45, Article 204.)

Page 595

**Advance royalties.**—In the new regulations the Department takes a more liberal attitude than that indicated by the author. Owners in receipt of royalties must report royalties as taxable income but are permitted to deduct depletion even though there has been no extraction during the taxable year. It is, however, provided that if the deductions were found to be unwarranted because the minerals were not really taken out, upon repossession the amount theretofore claimed for depletion must be returned as income for the year when the property is repossessed. The actual working out of this might result in the imposition of an extremely large tax for one year. It would be more equitable if amended returns were permitted.

**DEPLETION OF MINE BASED ON ADVANCE ROYALTIES.—**

**REGULATION.** Where the owner has leased a mining property for a term of years with a requirement in the lease that the lessee shall mine and pay for annually a specified number of tons or other agreed units of measurement of such mineral, or shall pay annually a specified sum of money which shall be applied in payment of the purchase price or agreed royalty per unit of such mineral whenever the same shall thereafter be mined and removed from the leased premises, the value in the ground to the lessor for purposes of depletion of the number of units so paid for in advance of mining will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the mining or removal in such year of any ore or mineral so paid for in advance and for which deduction has

been once made. If for any reason any such mining lease shall be terminated before the ore or mineral therein which has been paid for in advance has been mined and removed, and the lessor repossesses the leased property, an amount equal to the aggregate deductions for depletion allowed in respect of ore or mineral not mined and removed by the lessee, but still in the ground, will be deemed income to the lessor and will be returned as such for the year in which the property is repossessed. (Reg. No. 45, Article 215.)

### Page 598

**Mines—valuation and depletion regulations.**—In view of the changes in 1918 law the new regulations necessarily differ from Reg. No. 33, reproduced on pages 598 to 602. As an analysis of the old and the new regulations would occupy more space than the insertion of the new regulations in full, the latter course is adopted.

#### DETERMINATION OF QUANTITY OF ORE IN MINE.—

**REGULATIONS.** Every taxpayer claiming a deduction for depletion will be required to estimate with respect to each separate property the total units (tons, pounds, ounces or other units) of ores and minerals reasonably known or on good evidence believed to have existed in the ground on March 1, 1913, or on the date of acquisition of the property, or within 30 days after the date of discovery, as the case may be. In estimating the total units of ores and minerals for purposes of depletion the property must be considered in the condition in which it was on March 1, 1913, or the date of acquisition, or within 30 days after the date of discovery, but if subsequently during the ownership of the taxpayer making the return additional recoverable mineral deposits have been discovered or developed which were not taken into account in estimating the number of units for purposes of depletion, or if it shall be discovered by working, development or exploration that ground previously estimated to contain commercially recoverable mineral is barren or contains only commercially unworkable mineral, a new estimate of the recoverable units of ores or minerals shall be made and when made shall thereafter constitute a basis for depletion. In the selection of the unit of estimate the custom or practice applicable to the type of mineral deposit and the character of the operations thereon should be considered. The estimate of the recoverable units of ores or minerals for the purpose of depletion shall include (a) the ores and minerals "in sight," "blocked out," "developed," or "assured," in the

usual or conventional meaning of these terms in respect to the type of deposit, and may also include (b) "prospective" or "probable" ores and minerals (in the same sense), i.e., ores and minerals that are believed to exist on the basis of good evidence, although not actually known to occur on the basis of existing development, but "probable" or "prospective" ores and minerals may be computed for purposes of depletion only as extensions of known deposits into undeveloped ground. (Reg. No. 45, Article 208.)

STATEMENT TO BE ATTACHED TO RETURN WHERE DEPLETION OF MINE CLAIMED.—

To the return of the taxpayer claiming a deduction for depletion or depreciation or both there should be attached a statement setting out: (a) whether the owner is a fee owner or lessee or both; (b) a description of the property owned in fee, if any, and a description of the leasehold property, if any, including the date of acquisition and the date of expiration of the lease; (c) the fair market value as of March 1, 1913, or within 30 days of the date of discovery, or the cost, as the case may be, of the property owned in fee and the leasehold property, together with a statement of the precise method by which the value or the cost of freehold and leasehold property was determined; (d) the estimated number of units of mineral or ore at the date of acquisition or of valuation in the property owned in fee and in the leasehold property separately, together with an explanation of the method used in estimating in each case the number of units of mineral or ore for purposes of depletion; (e) the amount of capital applicable to each unit; (f) the number of units removed and sold during the year for which the return was made; (g) the total amount deducted on account of depletion and on account of depreciation, stated separately, up to the taxable year during the ownership of the taxpayer; and (h) any other data which would be helpful in determining the reasonableness of the depletion and depreciation deductions claimed in the return. (Reg. No. 45, Article 217.)

DISCOVERY OF MINE.—

The discovery of a mine or a natural deposit of mineral, whether it be made by an owner of the land or by a lessee, shall be deemed to mean (a) the bona fide discovery of a commercially valuable deposit of ore or mineral of a value materially in excess of the cost of discovery in natural exposure or by drilling or other exploration conducted above or below ground, or (b) the development and proving of a mineral or ore deposit which has been abandoned or appar-

ently worked out, or sold, leased or otherwise disposed of, by an owner or lessee prior to the development of a body of ore or mineral of sufficient size, quality and character to determine it, in connection with the physical and geological conditions of its occurrence, to be a mineable deposit of ore or mineral having a value materially in excess of the cost of the proving and development. In determining whether a discovery has been made the Commissioner will take into account the peculiar conditions of the case, and every taxpayer claiming the value of a mineral deposit on the date of discovery or within 30 days thereafter for purposes of depletion will be required to attach to his return a statement setting forth the conditions and circumstances of the discovery and the size, character and location of the deposit, together with the cost of discovery, its value and the precise method used in determining the value. (Reg. No. 45, Article 219.)

#### CHARGES TO CAPITAL AND TO EXPENSE IN THE CASE OF MINE.—

In the case of mining operations all expenditures for plant equipment, development, rent and royalty prior to production, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depletion and depreciation. After a mine has been developed and equipped to its normal and regular output capacity, however, the cost of additional minor items of equipment and plant, including mules, motors, mine cars, trackage, cables, trolley wire, fans, small tools, etc., necessary to maintain the normal output because of increased length of haul or depth of working consequent on the extraction of mineral, and the cost of replacements of these and similar minor items of worn-out and discarded plant and equipment, may be charged to current expense of operations. (Reg. No. 45, Article 222.)

#### DEPRECIATION OF IMPROVEMENTS IN THE CASE OF MINE.—

It shall be optional with the taxpayer, subject to the approval of the Commissioner, (a) whether the cost or value of the mining property, including ores and minerals, plant and equipment, and charges and additions to capital account not charged to expense and deducted as expense on the returns of the taxpayer, shall be recovered at a rate established by current exhaustion of mineral, or (b) whether the cost or value of the mineral and charges to capital account of expenditures other than for physical property shall be recovered by appropriate charges based on depletion and the cost or value of plant and equipment shall be recovered by reasonable charges for de-



preciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner. Nothing in these regulations shall be interpreted to mean that the value of a mining plant and equipment may be reduced by depreciation or depletion deductions to a sum below the value of the salvage when the property shall have become obsolete or shall have been abandoned for the purpose of mining, or that any part of the value of land for purposes other than mining may be recoverable through depletion or depreciation. (Reg. No. 45, Article 224.)

It will be noted that in the foregoing regulations the provision of the 1918 law that the depletion allowance in the case of new discoveries may be based upon the fair market value of the property at the date of the discovery or within 30 days thereafter, is fully dealt with.

Provision is made that many items which are ordinarily deemed to be capital expenditures, such as mine cars, motors, etc., may be charged to current expenses when such purchases become necessary because of increased length of haul or depth of working. In the instructions which govern the determination of the amount of ore in the mine as contained in Article 208, it is provided that the estimate must include minerals "assured" and may include prospective or probable quantities. In making this estimate due consideration should be given to the comments on pages 596 to 598. In some cases estimates of possible future extraction have been so large as to make the annual depletion rate a negligible factor. Such a result proves the inaccuracy of the estimate, as purchases of mines are not made on such a basis.

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#### **Gas and oil wells—valuation and depletion.—**

##### **DETERMINATION OF QUANTITY OF OIL IN GROUND.—**

**REGULATIONS.** In the case of either an owner or lessee it will be required that an estimate, subject to the approval of the Commissioner, shall be made of the probable recoverable oil contained in

the territory with respect to which the investment is made as of the time of purchase, or as of March 1, 1913, if acquired prior to that date, or within 30 days after the date of discovery, as the case may be. The oil reserves must be estimated for all undeveloped proven land as well as producing land. If information subsequently obtained clearly shows the estimate to have been materially erroneous, it may be revised with the approval of the Commissioner. (Reg. No. 45, Article 209.)

#### COMPUTATION OF ALLOWANCE FOR DEPLETION OF GAS WELLS.—

On account of the peculiar conditions surrounding the production of natural gas it will be necessary to compute the depletion allowances for gas properties by methods suitable to the particular cases in question and acceptable to the Commissioner. Usually, the depletion of natural gas properties should be computed on the basis of decline in closed or rock pressure, taking into account the effects of water encroachment and any other modifying factors. The following methods may also be used. In many fields more or less additional evidence on depletion is to be had from such considerations as (a) details of production (performance record of well or property); (b) decline in open flow capacity; (c) comparison with life histories of similar wells or properties, particularly those now exhausted; and (d) size of reservoir and pressure of gas. In using the closed pressure decline method, the pressure at which wells are abandoned may be subtracted from the observed pressures in order to determine the correct percentages. The estimates for properties in certain fields are subject to some further correction for various reasons, among which are (a) irregular encroachment of water or oil which reduces the rate of decline in pressure; (b) even though there be no encroachment of oil or water, the size of the reservoir remaining fixed, the pressure decline does not follow in exact and precise proportion to the amount withdrawn; and (c) as a rule less gas is marketed for 50 pounds of decline in the early history of the well than during the decline of a similar amount in the later history or after the pressure has become low. The gas producer will be expected to compute the depletion as accurately as possible and submit with his return a description of the method by which the computation was made. The following formula, in which the units of gas are pounds per square inch of closed pressure, may be used and is recommended: the quotient of the capital account recoverable through depletion allowances to the end of the taxable year, divided by the sum of the pressures at the beginning of the year less the sum of the pressures at the time of expected abandonment (which quotient is the unit

cost), multiplied by the sum of the pressures at the beginning of the taxable year plus the sum of the pressures of new wells less the sum of the pressures at the end of the tax year, equals the depletion allowance. (Reg. No. 45, Article 211.)

#### PROCEDURE FOR COMPUTATION OF DEPLETION OF GAS WELLS IN THE FUTURE.—

A closed pressure reading of a gas well which has been producing, or is near gas wells that have been producing, is reduced to a greater or less extent, depending on its location and the length of time it has been closed in. To get readings most useful for tax purposes it is necessary to record the length of time the well has been closed and to show how the pressure built up during this period. Several readings at successive times will tend to indicate the point at which the pressure becomes approximately stationary, that is, the point at which the closed pressure approaches as nearly as possible the maximum pressure which would be shown if the well and all others in the pool were closed for several months. The length of time required varies of course with the character of the sand, position of the packer, the location of the well with reference to other wells, the limits of the pool and other considerations. The depth of the well, diameter of tubing, and line pressure when the well was shut off should be noted. Beginning with 1919, closed pressure readings of representative wells, if not of all wells, must be carefully made and kept. In order to standardize pressure readings, the well should remain closed until such time as the pressure will not build up more than 1 per cent of the total pressure in 10 minutes. Ordinarily 24 hours will suffice for this purpose, but some wells will need to remain closed for a longer period. If there is any water in the well it should be blown or pumped off before the well is closed. Since readings at the exact end of the fiscal year will ordinarily not be available, the pressure of that date may be obtained by interpolation or extrapolation, or in certain cases readings taken regularly in September or some other month may be applicable to the end of the fiscal or tax year. As a general rule September closed pressure readings taken regularly furnish the best indication of depletion and it is recommended that such readings be made with especial regularity and care. Where interpolated readings are used the data from which they are obtained should be given. Gauges should be of appropriate capacity considering the pressure to be measured and should be frequently tested. Record should be kept of the numbers of the gauges, dates the gauges were tested, names of men testing, and other significant details. (Reg. No. 45, Article 212.)

COMPUTATION OF ALLOWANCE WHERE QUANTITY OF OIL  
OR GAS UNCERTAIN.—

If for any reason the quantity of oil or gas on the property cannot be determined with any degree of certainty, thus precluding the use of the unit cost method of computing depletion, the depletion deduction may be computed in accordance with some other method or rule satisfactory to the Commissioner. In case any method other than the unit cost method is proposed to be used by the taxpayer in computing his depletion allowance, a full description of the method used must be submitted with the return, together with a summary of the figures or calculations pertaining to such computation. (Reg. No. 45, Article 213.)

COMPUTATION OF DEPLETION ALLOWANCE FOR COMBINED  
HOLDINGS OF OIL AND GAS WELLS.—

(1) *Oil properties.*—The recoverable oil belonging to the taxpayer shall be estimated separately on the smallest unit on which data are available, such as individual wells or tracts, and these added together into a grand total to be applied to the total capital account returnable through depletion. The capital account shall include the cost or value, as the case may be, of all oil or gas leases or rights within the United States and its possessions, plus all incidental costs of development not charged as expense nor returnable through depreciation. The unit value of the total recoverable oil or gas is the quotient obtained by dividing the total capital account recoverable through depletion by the total estimated recoverable oil or gas. This unit multiplied by the total number of units of oil or gas produced by the taxpayer during the taxable year from all of the oil and gas properties will determine the amount which may be allowably deducted from the gross income of that year. This total depletion allowance divided by the total capital account returnable through depletion will give the percentage of depletion for the taxable year. This percentage must be applied to the capital account returnable through depletion of each separate leasehold and fee property included in the holdings of the taxpayer to find the proper amount deductible for depletion from the capital account of each tract at the end of the taxable year.

(2) *Gas properties.*—In the case of the gas properties of a taxpayer the depletion allowance for each pool may be computed by using the combined capital account returnable through depletion of all the tracts of gas land owned by the taxpayer in the pool and the average decline in rock pressures of all the taxpayer's wells in such pool as in the formula given in Article 211. The total allowance for

depletion of the gas properties of the taxpayer will be the sum of the amounts computed for each pool. (Reg. No. 45, Article 214.)

STATEMENT TO BE ATTACHED TO RETURN WHERE DEPLETION OF OIL OR GAS CLAIMED.—

To each return made by a person owning or operating oil or gas properties, there should be attached a statement showing for each property the following information, which may be given in the form of a table, if desired, by taxpayers owning more than one property: (a) the fair market value of the property (exclusive of machinery, equipment, etc., and the value of the surface rights) as of March 1, 1913, if acquired prior to that date; or the fair market value of the property within 30 days after the date of discovery; or the actual cost of the property, if acquired subsequently to February 28, 1913, and not covered by the foregoing clause; (b) how the fair market value was ascertained, if the property came under the first or second head under (a); (c) the estimated quantity of oil or gas in the property at the time that the value or cost was determined; (d) the name and address of the person making the estimate and the manner in which this estimate was made, including a summary of the calculations; (e) the amount of capital applicable to each unit (this being found by dividing the value or cost, as the case may be, by the estimated number of units of oil or gas in the property at the time the value or cost was determined); (f) the quantity of oil or gas produced during the year for which the return is made (in the case of new properties it is desirable that this information be furnished by months); (g) the number of acres of producing and proven oil or gas land; (h) the number of wells producing at the beginning and end of the taxable year; (i) the date of completion of wells finished during the taxable year; (j) the date of abandonment of all wells abandoned during the taxable year; (k) a property map showing the location of the property and of the producing and abandoned wells, dry holes, and proven oil and gas land; (l) the average gravity of the oil produced on the tract; (m) the number of pay sands and average thickness of each pay sand or zone on the property; (n) the average depth to the top of each of the different pay sands; (o) any data regarding change in operating conditions, such as flooding, use of compressed air, vacuum, shooting, etc., which have a direct effect on the production of the property; (p) the monthly or annual production of individual wells and the initial daily production of new wells (this is highly desirable information and should be furnished wherever possible); (q) (for the first year in which the above information is filed for a property which was producing prior to the taxable year covered by the above statement

the following information must be furnished) annual production of the tract or of the individual wells, if the latter information is available, from the beginning of its productivity to the beginning of the taxable year for which the return was filed; the average number of wells producing during each year; and the initial daily production of each well; and (r) any other data which will be helpful in determining the reasonableness of the depletion deduction. When a taxpayer has filed adequate maps with the Commissioner he may be relieved of filing further maps of the same properties, provided all additional information necessary for keeping the maps up to date is filed each year. This includes records of dry holes, as well as producing wells, together with logs, depth and thickness of sands, location of new wells, etc. By "production" is meant gross production of all oil or gas recovered from the wells and tanked or utilized. In those leases where no account is kept of the oil or gas used for fuel, the gross production will necessarily be that remaining after the fuel used in the property has been taken out. In cases of this kind an estimate of the fuel used from each tract should be given for each year. (Reg. No. 45, Article 218.)

#### DISCOVERY OF OIL AND GAS WELLS.—

In order to take advantage of his discovery on or after March 1, 1913, of oil or gas wells, the taxpayer must show (a) that the tract for which such valuation is claimed was not as to the particular sand or zone discovery of which is claimed proven oil land at the time the so-called discovery was made, proven oil land being that which has been shown by finished wells, supplemented by geologic data, to be such that other wells drilled thereon are practically certain to be commercial producers; (b) that the discovery was a bona fide discovery of a commercial well of oil or gas or both of these substances on the property in question, a commercial well being one whose production is such as to offer a reasonable expectation of at least returning the capital invested in such well through the sale of the oil or gas or both derived therefrom during its economic life; and (c) that the fair market value of the property was materially in excess of the cost. (Reg. No. 45, Article 220.)

#### PROOF OF DISCOVERY OF OIL AND GAS WELLS.—

In order to meet the requirements of the preceding article to the satisfaction of the Commissioner, the taxpayer will be required, among other things, to submit the following with his return: (a) a

map of convenient scale, showing the location of the tract and discovery well in question and of the nearest producing well, and the development for a radius of at least 3 miles from the tract in question, both on the date of discovery and on the date when the fair market value was set; (b) a certified copy of the log of the discovery well, showing the location, the date drilling began, the date of completion and beginning of production, the formations penetrated, the oil, gas and water sands penetrated, the casing record, and any other information tending to show the condition of the well on the date the discovery was claimed; (c) the logs of enough other wells drilled prior to the date of completion of the discovery in the vicinity of the discovery well to convince the Commissioner that the sand or zone discovery of which is claimed was not known prior to the so-called discovery; (d) a sworn record of production, clearly proving the commercial productivity of the discovery well; (e) a sworn copy of the records, showing the cost of the property; and (f) a full explanation of the method of determining the value on the date of discovery or within 30 days thereafter, supported by satisfactory evidence of the fairness of this value. (Reg. No. 45, Article 221.)

#### CHARGES TO CAPITAL AND TO EXPENSE IN THE CASE OF OIL AND GAS WELLS.—

Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines and development of the property may at the option of the taxpayer be deducted as an operating expense or charged to the capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property, it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling non-productive wells may at the option of the operator be deducted from gross income as an operating expense or charged to capital accounts returnable through depletion and depreciation as in the case of productive wells. Casing-head-gas contracts have been construed to be tangible assets and their cost may be added to the capital account returnable through depletion, following the rate set by the oil wells from which the gas is derived, or if the life of the contract is shorter than the reasonable expectation of the life of the wells furnishing the gas, the capital invested in the contract may be written off through yearly allowances equitably distributed over the life of the contract. All oil produced during the taxable year, whether sold or unsold, must be considered in the computation of the depletion allowance for the taxable year. (Reg. No. 45, Article 223.)

DEPRECIATION OF IMPROVEMENTS IN THE CASE OF OIL AND GAS WELLS.—

Both owners and lessees operating oil or gas properties will, in addition to and apart from the deduction allowable for the depletion or return of capital as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under Article 223. The amount deductible on this account shall be such an amount based upon its capitalized value or cost equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation may for such property be based upon the length of life of the deposit. (Reg. No. 45, Article 225.)

DEPLETION AND DEPRECIATION OF OIL AND GAS WELLS IN YEARS BEFORE 1916.—

If upon examination it is found that in respect of the entire drilling cost of wells, including physical property and incidental expenses, between March 1, 1913, and December 31, 1915, a taxpayer has been allowed a reasonable deduction sufficient to provide for the elements of exhaustion, wear and tear, and depletion, it will not be necessary to reopen the returns for years prior to 1916 in order to show separately in these years the portions of such deduction representing depletion and depreciation, respectively. Such separation will be required to be made of the reserves for depreciation at January 1, 1916, and proper allocation between depreciation and depletion must be maintained after that date. In any case in which it is found that the deductions taken between March 1, 1913, and December 31, 1915, are not reasonable, amended returns may be required for these years. (Reg. No. 45, Article 226.)

It will be noted that in the determination of the total quantity removable, an estimate must be made for all undeveloped proven land (Article 209), as well as producing land. It is obvious that if an optimistic estimate is made, such as estimates in some of the literature regarding oil prop-



erties which is now being circulated, the annual depletion allowance will be very small.

The Department has always been disposed to allow reasonable depletion charges when the circumstances of any particular case differentiated that case from others.

In connection with computation of depreciation (Article 225) it is recognized that "the reasonable expectation of the economic life" may increase the amount of depreciation. This principle also applies to depletion charges.

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**Timber—valuation and depletion.**—The new regulations are more comprehensive than the old and are therefore reproduced in full. Article 230 regarding revaluation is somewhat more liberal than the regulation quoted on page 610.

#### DEPLETION OF TIMBER.—

**REGULATIONS.** A reasonable deduction from gross income for the depletion of timber and for the depreciation of improvements is permitted, based (a) upon cost if acquired after February 28, 1913, or (b) upon the fair market value as of March 1, 1913, if acquired prior thereto. The essence of this provision is that the owner of timber property, whether it be a leasehold or a freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the amount of capital invested by him in the property, or in lieu thereof an amount equal to its fair market value as of March 1, 1913, plus in any case the subsequent cost of plant, equipment, and development which is not chargeable to current operating expenses, but not including cut-over land values. (Reg. No. 45, Article 227.)

#### CAPITAL RECOVERABLE THROUGH DEPLETION ALLOWANCE IN THE CASE OF TIMBER.—

In general, the capital remaining in any year recoverable through depletion allowances may be determined as indicated in Articles 202 and 203. In the case of leases the apportionment of deductions between the lessor and lessee should be made as specified in Article 204. Where it becomes necessary to determine the cost or fair market

value as of March 1, 1913, of the property, the rules laid down in Articles 205 and 206 should be followed so far as possible. (Reg. No. 45, Article 228.)

COMPUTATION OF ALLOWANCE FOR DEPLETION OF TIMBER.—

An allowance for the depletion of timber in any taxable year shall be based upon the number of feet of stumpage cut during the year and the unit cost of the stumpage at the date of acquisition or the unit market value on March 1, 1913, if acquired prior thereto. The unit market value as of March 1, 1913, shall be the unit price at which the standing timber in its then condition and in view of its then environment could have been sold for cash or its equivalent. The amount of the deduction for depletion in any taxable year shall be the product of the number of feet of stumpage cut during the year multiplied by such unit cost or market value of the stumpage. (Reg. No. 45, Article 229.)

REVALUATION OF STUMPAGE.—

The fair market value of stumpage when determined as of March 1, 1913, for the purpose of depletion allowances in the case of timber acquired prior thereto, shall be the basis for determining the depletion deduction for each year during the continuance of the ownership under which the fair market value of the stumpage was fixed, and during such ownership there can be no redetermination of the fair market value of the stumpage for such purpose. However, the unit market value of stumpage adopted by the taxpayer may subsequently be changed if from any cause such value, if continued as a basis of depletion, should upon evidence satisfactory to the Commissioner be found inadequate or excessive for the extinguishment of the fair market value of the timber as of March 1, 1913. (Reg. No. 45, Article 230.)

CHARGES TO CAPITAL AND TO EXPENSE IN THE CASE OF TIMBER.—

In the case of timber operations all expenditures for plant, equipment, development, rent and royalty prior to production, and thereafter all major items of plant and equipment, shall be charged to capital account for purposes of depreciation. After a timber operation and plant has been developed and equipped to its normal and regular output capacity, the cost of additional minor items of equipment and the cost of replacement of minor items of worn-out and discarded plant and equipment may be charged to current expenses of operations. (Reg. No. 45, Article 231.)

DEPRECIATION OF IMPROVEMENTS IN THE CASE OF TIMBER.—

The cost or value as of March 1, 1913, as the case may be, of development not represented by physical property having an inventory value, and such cost or value of all physical property which has not been deducted and allowed as expense in the returns of the taxpayer, shall be recoverable through depreciation. It shall be optional with the taxpayer, subject to the approval of the Commissioner, (a) whether the cost or value, as the case may be, of the property subject to depreciation shall be recovered at a rate established by current exhaustion of stumpage, or (b) whether the cost or value shall be recovered by appropriate charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner. In no case may charges for depreciation be based on a rate which will extinguish the cost or value of the property prior to the termination of its useful life. Nothing in these regulations shall be interpreted to mean that the value of a timber plant and equipment, so far as it is represented by physical property having an inventory value, may be reduced by depreciation deductions to a sum below the value of the salvage when the plant and equipment shall have become obsolete or worn out or shall have been abandoned, or that any part of the value of cut-over land may be recoverable through depreciation. (Reg. No. 45, Article 232.)

STATEMENT TO BE ATTACHED TO RETURN WHERE DEPLETION OF TIMBER CLAIMED.—

To the return of the taxpayer claiming a deduction for depletion or depreciation or both there should be attached a statement setting out (a) whether the owner is an owner in fee or a lessee or both; (b) a description of the property owned in fee, if any, and a description of the leasehold property, if any, including the date of acquisition and the date of expiration of the lease; (c) the cost of the freehold and the leasehold property; (d) the number of feet of timber removed and sold during the year for which the return was made; (e) the total amount deducted on account of depletion and on account of depreciation, stated separately, up to the taxable year during the ownership of the taxpayer; and (f) any other data which would be helpful in determining the reasonableness of the depletion and depreciation deductions claimed in the return. The taxpayer shall keep accurate ledger accounts as outlined in Article 216, and in general should comply with the requirements of the foregoing articles relating to the depletion of mines and oil and gas wells so far as applicable. (Reg. No. 45, Article 233.)

## CHAPTER XXVIII

### NON-RESIDENT ALIENS

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#### Definition of non-resident aliens.—

REGULATION. "Non-resident alien individual" means an individual (a) whose residence is not within the United States, and (b) who is not a citizen of the United States. Any alien living in the United States who is not a mere transient is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to his stay. The best evidence of such intentions is afforded by the conduct, acts, and declarations of the alien. The typical transient is one who stops for a short time in the course of a journey through the United States, sometimes performing labor, sometimes not, or one who enters the United States intending only to stop long enough to carry out some purpose, object or plan not involving an extended stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. (Reg. No. 45, Article 311.)

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**Withholding by employers.**—From payments made to non-resident aliens, the amount to be withheld under Section 221 (a) of the 1918 law is 8 per cent. Prior to the passage of the 1918 law the rate of withholding was 2 per cent. Non-resident aliens are responsible for the entire 8 per cent from January 1, 1918, but employers who did not withhold at that rate until after the passage of the law (February 24, 1919) are not responsible for failure to withhold at the higher rate.

**WITHHOLDING AT THE NEW RATES—LIABILITY OF DEBTORS AND OF CREDITORS.**—Employers of non-resident aliens were not required in making payments prior to February 25, 1919, to withhold more than 2 per cent of such payments and as to such payments will not be held responsible for more than 2 per cent unless then actually withheld at a higher

rate. This ruling does not affect the tax liability of the non-resident alien who will be liable for tax at the rates prescribed for 1918 and 1919 and should make returns accordingly. He is entitled to credit for the amount paid to the government by withholding agent. (Telegram to The Corporation Trust Company, signed by Commissioner Daniel C. Roper and dated March 5, 1919.)

REGULATIONS. Credit for a personal exemption and for dependents in case of non-resident alien individual.—(a) The following is an incomplete list of countries which either impose no income tax or in imposing an income tax allow the similar credit required by the statute: Argentina, Brazil, Canada, Cuba, France, Italy, Mexico, Union of South Africa. (b) The following is an incomplete list of countries which in imposing an income tax do not allow the similar credit required by the statute: Australia, Great Britain and Ireland, Japan, New Zealand. A non-resident alien individual who is a citizen or subject of any country on the first list is entitled for the purpose of the normal tax to such credit for a personal exemption and for dependents as his family status may warrant. If he is a citizen or subject of any country on the second list he is not entitled to any such credit. If he is a citizen or subject of a country which is on neither list, then to secure credit for a personal exemption or for dependents or both he must prove to the satisfaction of the commissioner that his country does not impose an income tax or that in imposing an income tax it grants the similar credit required by the statute. (T. D. 2811, March 22, 1919.)

#### ALLOWANCE OF CREDITS TO NON-RESIDENT ALIEN EMPLOYEES.—

A non-resident alien employee, provided he is entitled under Section 216 of the statute to credit for a personal exemption or for dependents or both, may claim the benefit of such credit by filing with his employer form 1115, duly filled out and executed under oath. On the filing of such a claim his employer shall examine it. If, on such examination, it appears that the claim is in due form, that it contains no statement which, to the knowledge of the employer, is untrue, and that such employee, on the face of the claim, is entitled to credit, and that such credit has not yet been exhausted, then such employer need not, until such credit be in fact exhausted, withhold any tax from payment of salary or wages made to such employee. Every employer with whom affidavits of claim on form 1115 are filed by employees

shall preserve such affidavits until the following calendar year, and shall then file them, attached to his annual withholding return on form 1042 (revised), with the collector, on or before March 1. In case, however, when the following calendar year arrives, such employer has no withholding to return, he shall file all such affidavits of claim, so filed with him by employees, directly with the Commissioner (Sorting Division), with a letter of transmittal, on or before March 1. In all other cases benefit of the credits allowed against net income for the purpose of the normal tax may not be received by a non-resident alien by filing a claim with the withholding agent, but only by claiming them upon filing a return of income as prescribed in Article 403. (T. D. 2811, March 22, 1919.)

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### **Exemption from withholding.—**

**REGULATION.** Withholding from interest on bonds or other obligations containing a tax-free covenant shall not be required in the case of a citizen or resident alien individual if he files with the withholding agent when presenting interest coupons for payment, or not later than February first following the taxable year, an ownership certificate on form 1001 (revised) claiming a personal exemption or credit for dependents. To avoid inconvenience a resident alien individual should file a certificate of residence on form 1078 (revised) with withholding agents, who shall forward such certificates to the Commissioner (Sorting Division) with a letter of transmittal. Notwithstanding the provisions of Section 217 of the statute, withholding is required from income of a non-resident individual. No withholding from corporate dividends is required in any case. The income of domestic and resident foreign corporations is free from withholding. (Reg. No. 45, Article 362.)

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### **Gross income.—**

#### **GROSS INCOME OF NON-RESIDENT ALIEN INDIVIDUALS.—**

**REGULATIONS.** In the case of non-resident alien individuals "gross income" means only the gross income from sources within the United States, including interest on bonds, notes or other interest bearing obligations of residents, corporate or otherwise, dividends from resident corporations, amounts received representing profits on the manufacture or disposition of goods within the United States, rentals and royalties from property and income from business carried on in the United States, income from isolated transactions or activi-

ties, directly resulting in gain, carried on within the United States by a non-resident or his representative in person, interest on deposits in banks located within the United States, income from capital otherwise invested in the United States, and income from services rendered or labor performed within the United States. (Reg. No. 45, Article 91.)

**INCOME OF NON-RESIDENT ALIEN INDIVIDUALS NOT SUBJECT TO TAX.—**

Salaries, wages, commissions and rents paid by domestic business enterprises to non-resident alien employees for services rendered entirely in a foreign country or for property located in a foreign country are not subject to tax as income from a source within the United States. Dividends on stock and interest on notes of corporations organized in the United States, but doing no business and owning no property therein, paid to non-resident alien individuals or corporations, are not subject to the tax. The tax does not apply to charter money received by a foreign owner for a vessel operated between the United States and foreign ports, if the making of the charter contract grows out of no solicitation or similar commercial activity by the owner or his representative in person within the United States. (Reg. No. 45, Article 92.)

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**Forms for making returns by non-resident aliens.—**Form 1040B will not be issued for use of non-resident aliens. Form 1040 or 1040A will be used. Instructions are now being prepared as to how these forms may be adapted for use of non-resident aliens. (Telegram to a subscriber of The Corporation Trust Company, March 14, 1919.)

Articles 443 and 444 of Reg. No. 45 provide in the case of non-resident alien individuals or corporations or their proper representatives in the United States an extension of time for filing returns of 1918 to such period as may be necessary not exceeding 90 days after the proclamation of peace. The same extension is granted to enemies or allies of enemies.

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**Deductions of foreign corporations.—**

**REGULATION.** Foreign corporations are allowed the same deductions from their gross income arising from sources within the United

States as are allowed to domestic corporations, to the extent that such deductions are connected with such gross income, with the exception that the interest deductible is that proportion of so much of the entire interest paid on the corporate indebtedness as would be deductible if paid by a domestic corporation which the gross income from sources within the United States bears to the total gross income, and that full deduction may be made for taxes imposed by the United States or any of its possessions, or by any state, territory or political subdivision thereof, except taxes for local benefits and income, war profits and excess profits taxes. A Canadian manufacturing corporation which sells part of its product in the United States and part in Canada should report its deductions for cost of manufacture, exclusive of interest paid on its indebtedness, in the same proportion as the quantity of its product sold in the United States bears to the total quantity sold. (Reg. No. 45, Article 571.)

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**Foreign corporations—determination of excess profits tax.**

—Form 1120, page 1 of instructions, Section 10, directs that the corporation must compute its tax in the first instance upon the basis of a tax equal to 50 per cent of the net income. This conforms to the law, Section 328 (b), because the tax to be imposed upon all foreign corporations must be determined under the relief Sections 327 and 328. It is questionable whether this is an equitable method of imposing the tax in view of the delay which may follow the administration of these two sections. As to domestic corporations the rule is quite fair because no corporation need be assessed under Section 328 unless it so elects, but many foreign corporations during 1918 made a very small profit and the requirement that in all cases their tax must in the first instance be calculated as if the actual tax would be at least 50 per cent of the net income might work a serious hardship. The law certainly contemplated that Sections 327 and 328 should be used only to work equity. Therefore, a foreign corporation which knows that its tax will be less than 50 per cent of its net income should make immediate application for a determination of a rate more nearly in accord with the facts.

If a foreign corporation is able to show that it has in-



vested in this country a minimum amount of invested capital as to which there is no question, based upon which the instalments of tax would be considerably less than 50 per cent, such corporation should be able to secure immediate action under the following regulation. It will be noted that this procedure is permitted in the case of domestic corporations.

DETERMINATION OF FIRST INSTALMENT OF TAX IN SPECIAL CASES.—

REGULATION. In the case of a foreign corporation, and in the case of any other corporation where absolutely no data are available for the determination of the invested capital for the taxable year, the instalments of the tax shall, in the first instance, be computed and the first instalment paid upon the basis of a tax equal to 50 per cent of the net income. In any other case under Section 328, including a case where the invested capital for the taxable year cannot be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the instalments shall in the first instance be computed and the first instalment paid upon the basis of a tax upon the minimum amount of invested capital, not, however, exceeding a tax upon the basis of 50 per cent of the net income. In any of the above cases the actual ratio when ascertained shall be used in determining the correct amount of the tax. (Reg. No. 45, Article 912.)

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**Return by agent.**—The new regulations explain the procedure to be followed by responsible representatives of non-resident aliens, but no definite statement is made as to what constitutes responsibility. It is therefore expected that further regulations will be issued.

RETURN OF INCOME OF NON-RESIDENT ALIEN.—

REGULATION. A non-resident alien individual shall make or have made a full and accurate return on form 1040 (revised) of income received from sources within the United States, regardless of amount, unless the tax on such income has been fully paid at the source. The responsible representatives of non-resident aliens in connection with any sources of income which such non-resident aliens may have within the United States shall make a return of such income, and shall pay any and all tax, normal and additional, assessed upon the income

received by them in behalf of their non-resident alien principals, in all cases where the tax on income so in their receipt, custody or control shall not have been withheld at the source. The agent of a non-resident alien is responsible for a correct return of all income accruing to his principal within the purview of the agency. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. Where, upon filing a return of income, it appears that a non-resident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return, there should be attached to the return a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. (Reg. No. 45, Article 403.)

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### **Porto Rico and Philippine Islands.—**

#### **INDIVIDUALS.—**

**REGULATION.** (a) A citizen of the United States who resides in Porto Rico, and a citizen of Porto Rico who resides in the United States, are taxed in both places, but the income tax in the United States is credited with the amount of any income, war profits and excess profits taxes paid in Porto Rico. (b) A resident of the United States, who is not a citizen of Porto Rico, is taxable in Porto Rico as a non-resident alien individual on any income derived from sources within Porto Rico, but the income tax in the United States is credited with the tax paid in Porto Rico. (c) A resident of Porto Rico, who is not a citizen of the United States, is taxable in the United States as a non-resident alien individual on any income derived from sources within the United States, and receives no credit. The same principles apply in the case of the Philippine Islands. (Reg. No. 45, Article 1132.)

#### **CORPORATIONS.—**

(a) A United States corporation which derives income from sources within Porto Rico, (b) a Porto Rico corporation which derives income from sources within the United States, and (c) a corporation of a foreign country which derives income both from sources within Porto Rico and from sources within the United States, are all taxed in both places. In the case of the United States corporation the income, war profits and excess profits taxes in the United States are credited with the amount of any income, war profits and excess profits taxes paid in Porto Rico. In the case of the Porto Rico corporation there is no such credit. The corporation of the foreign country deriving income from both places is subject to no double taxation so far as the United States and Porto Rico are con-

cerned. For the purpose of withholding a Porto Rico corporation is a foreign corporation. The same principles apply in the case of the Philippine Islands. (Reg. No. 45, Article 1133.)

## CHAPTER XXIX

### FIDUCIARIES

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**Returns of fiduciaries.**—The following extract from the new *Excess Profits Tax Primer* summarizes the returns which must under certain conditions be made by trustees.

**RULINGS.** Is the trustee having charge of a trust estate, the net income of which is periodically distributed among the beneficiaries, required to render a return?

Every fiduciary, or at least one of joint fiduciaries, must make a return (a) for the individual whose income is in his charge, if the net income of such individual is \$2,000 or over, if married and living with husband or wife, or is \$1,000 or over in other cases, or (b) for the estate or trust for which he acts, if the net income of such estate or trust is \$1,000 or over or if any beneficiary of such estate or trust is a non-resident alien. The return in case (a) and also in case (b) if the tax is payable by the fiduciary shall be on form 1040 (revised), except that it may be on short form 1040 A (revised) where the net income does not exceed \$5,000. The return shall be on form 1041 (revised) in case (b) if the tax is payable by the beneficiaries. If the net income of a decedent from the beginning of the taxable year to the date of his death was \$1,000 if unmarried, or \$2,000 if married, the executor or administrator shall make a return for such decedent. (*Excess Profits Tax Primer*, 1919, question 102.)

Where, in the case of more than one trust, the creator in each instance is the same person, and the trustee in each instance is the same, how will the trustee account for the income of the several trusts?

The trustee should make a single return on form 1041 for all the trusts in his hands, notwithstanding the fact that they arise from different instruments. When a trustee holds trusts created by different persons for the benefit of the same beneficiary he should make return for each trust separately on form 1041. This ruling is based on the identity of the trustee of the various trusts and not upon the identity of the beneficiary. (*Excess Profits Tax Primer*, 1919, question 113.)

**Return for non-resident alien beneficiary.—**

REGULATION. Where a citizen or resident fiduciary has the distribution of trust income for which there is a non-resident alien beneficiary, the fiduciary must make a return on form 1040 (revised) or 1040 A (revised) for such non-resident alien and pay the tax. If there are two or more beneficiaries, the fiduciary shall render a return on form 1041 (revised) and also a return on form 1040 (revised) or 1040 A (revised) for each non-resident alien beneficiary. (Reg. No. 45, Article 425.)

The authority for the foregoing regulation is not clear as to the requirement that the fiduciary must pay the tax in those cases where the income has been distributed to the beneficiary. Section 225 of the law requires a fiduciary to make a return for the individual estate or trust for which he acts. If the income is being distributed, he is acting for the estate but not for the beneficiary.

**Returns by receivers.**—The Department has held that receivers in certain proceedings have been required to make returns. The new regulations specifically specify that receivers in partition and similar proceedings are not required to render return of income.

REGULATION. A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040 A (revised). When acting for a corporation a receiver is not treated as a fiduciary, and in such case the return shall be made as if by the corporation itself. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business

of an individual or corporation must make returns. Every receiver for an individual, partnership or corporation, whether or not of all the property or business, must render a return of information under Section 256 of the statute. (Reg. No. 45, Article 424.)

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**Valuation of property acquired by inheritance.**—The new regulations amplify the former procedure. The Department holds that when property passes by gift or bequest the appreciation, if any, in the value of the property transferred before the date of transfer is not taxable income.

REGULATION. . . . No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income taxable to the estate. (Reg. No. 45, Article 342.)

## CHAPTER XXX

### INSURANCE COMPANIES

Page 671

#### **Gross income.—**

#### **GROSS INCOME OF INSURANCE COMPANIES.—**

REGULATIONS. The gross income of insurance companies consists of their total revenue derived from the operation of the business and of their income from all other sources within the year for which the return is made, except as otherwise provided by the statute. Gross income includes net premiums, investment income, income from the sale of capital assets, and all gains, profits and income reported to the state insurance departments, except income specifically exempt from tax. Amounts of premium received and paid out under reinsurance treaties should be eliminated from both income and disbursements. Deposit premiums on perpetual risks received and returned should be treated in the same manner, as no reserve will be considered covering liability for such deposits, but the earnings on such deposits will be included in the investment income. A net decrease in

reserve funds within the taxable year must be included in the gross income. (Reg. No. 45, Article 546.)

#### GROSS INCOME OF LIFE INSURANCE COMPANIES.—

The amount which a life insurance company is authorized to exclude from gross income on account of any premium refunded to an individual policy-holder is limited to an amount not in excess of the actual premium paid by the policy-holder within the taxable year. Where the dividend paid is in excess of the premium received, there can be excluded from gross income only the amount of the premium received from the policy-holder within the same year. Dividends provisionally ascertained, apportioned or credited on deferred dividend policies cannot be excluded or deducted from the total income received, for the reason that the assured has no vested or enforceable right in them and cannot at the time of the ascertainment, apportionment or credit, nor until the maturity of the policy, avail himself of such dividend, and that in the event of the death of the assured prior to the expiration of the deferred dividend period the amount so ascertained, apportioned or credited lapses. Book income of life insurance companies which consists of "dividends applied to purchase paid-up additions and annuities," "dividends applied to pay renewal premiums," and "dividends applied to shorten the endowment or premium-paying period," shall not be included in gross income except when the dividends applied are declared on paid-up participating policies. (Reg. No. 45, Article 547.)

#### DEDUCTIONS ALLOWED INSURANCE COMPANIES.—

Insurance companies are entitled to the same deductions as other corporations. As payments on policies there should be reported all death, disability or other policy claims (other than dividends) paid within the year, including fire, accident, and liability losses, matured endowments, annuities, payments on instalment policies and surrender values. There may also be deducted as losses agency balances or other amounts charged off, losses from defalcation, and premium notes voided by lapse provided such notes have at some time been included in returns of income. Taxes paid by insurance companies on the value of their stock outstanding and in the hands of stockholders are not deductible. Mutual marine insurance companies may include in their deductions from gross income amounts repaid to policy-holders on account of premiums previously paid by them and interest paid upon such amounts between the date of ascertainment thereof and the date of payment thereof, provided such amounts and interest have been included in gross income. (Reg. No. 45, Article 569.)

## RESERVES OF INSURANCE COMPANIES.—

By a special provision insurance companies are entitled to deduct in addition to all other deductions the net addition required by law to be made within the taxable year to reserve funds. This is considered to mean the net addition required by the specific statutes of the states within which the taxpayer transacts business. A requirement by a state insurance commissioner that a net addition shall be made to certain amounts retained to meet specified liabilities is not a net addition required by law to be made to reserve funds within the meaning of the statute. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. The net addition to the fund maintained to pay incurred losses is not a legal deduction from gross income. In the case of casualty companies reserve funds consist of amounts maintained to meet the "unearned-premium" liability and the "unpaid-loss" liability. In the case of life insurance companies the net addition to the "reinsurance reserve" and the "reserve for supplementary contracts not involving life contingencies," and the net addition to any other reserve funds necessarily maintained for the purpose of liquidating policies at maturity, are legally deductible. An increase in the amount maintained by a life insurance company to pay dividends on deferred dividend policies may not be deducted from gross income. An assessment insurance company is entitled to deduct from gross income the increase in the amount which it is required by law to keep on deposit with state insurance departments as a protection to policy-holders. Mutual hail and mutual hail and cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make under the laws of the states in which they operate to the "guaranty surplus" fund or similar fund. Corporations issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, will be permitted to include in the net addition to reserve funds the net addition to any fund specially maintained for the protection of policy-holders of the above class. (Reg. No. 45, Article 570.)

## RETURNS OF INSURANCE COMPANIES.—

Insurance companies transacting business in the United States or deriving an income from sources therein are required to file returns of income. The return shall be on form 1120. The returns of insurance companies must be rendered in conformity with the re-

ports made for the same period to state insurance departments. As an aid, in auditing the returns, wherever possible a copy of the report to the state insurance department should be submitted with the return. Otherwise a schedule should be attached thereto showing the federal, state, and municipal obligations from which the interest omitted from gross income was derived. (Reg. No. 45, Article 623.)

## CHAPTER XXXI

### FARMERS

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**Instructions to farmers—1919 returns.**—The schedule provided for farmers under the 1918 law (form 1040F) follows.



Form 1040 F—UNITED STATES INTERNAL REVENUE SERVICE

**SCHEDULE OF FARM INCOME AND EXPENSES**TO BE SENT WITH RETURN FORM 1040 A OR 1040 TO THE COLLECTOR OF  
INTERNAL REVENUE ON OR BEFORE MARCH 15, 1919

Name .....

Address .....

**INSTRUCTIONS**

This work sheet or schedule of farm income and expenses is to be used in determining the net income from a farm business. It may be used by farm owners who work their own farms or rent them out on shares, or by tenants.

If you have two or more farms, it may be desirable to fill out a separate sheet for each farm.

This schedule is to be delivered to the Collector of Internal Revenue with your income tax return (Form 1040A or Form 1040). You should keep a copy for reference next year.

**INCOME**

All the farm income from whatever source must be reported in this schedule. Only income actually received need be included, but this does not mean that the taxpayer must receive cash. Anything of value received instead of cash must be considered income to the extent of its cash value. Thus, the value of groceries, merchandise, etc., received in exchange for eggs, butter, or other produce must be reported as income.

The value of farm produce which is consumed by the farmer and his family need not be reported as income; but expenses incurred in raising produce thus consumed must not be claimed as deductions.

If timber sold in 1918 was grown in part before March 1, 1913, the income to be reported is the difference between the fair market value of such timber on March 1, 1913, and the price received, less any expenses of growing the timber that have not heretofore been claimed as deductions. Report such income in the same manner as income from sale of land, in Schedule D of Form 1040A or Form 1040.

**EXPENSES AND OTHER DEDUCTIONS**

Report as farm expenses only amounts actually paid out in carrying on the farm business.

**Labor.**—Only that part of the board of hired labor which is purchased should be claimed as a deduction. The value of products furnished by the farm and used in the board of hired labor is not a deductible expense.

Rations purchased and furnished to laborers or share-croppers are deductible as a part of the labor expense.

Do not deduct the value of your own labor or that of your wife or dependent minor children.

Do not deduct amounts paid to persons engaged in household work except to the extent that the services of such employees are used in boarding and otherwise caring for farm laborers. Services of employees engaged in caring for the farmer's own household are not a deductible expense.

**Fertilizers, manures, etc.**—The cost of manures, commercial fertilizers, lime, raw rock phosphate, etc., that were bought during the year may be included as an expense.

**Taxes.**—Do not deduct inheritance or estate taxes, Federal income taxes, drainage taxes, or taxes for any improvement or betterment

tending to increase the value of the property. Be ready to show tax receipts if possible. Do not deduct taxes on your dwelling or household property.

**Interest on indebtedness.**—All interest paid on farm mortgages, notes, and other obligations incurred to carry on the farm business should be deducted.

**Bad debts.**—Report only debts arising from sales that have been reported as income, which have been definitely proved within the year to be worthless.

**Repairs and depreciation.**—Depreciation claimed should not exceed the actual cost of the property (or its fair market value March 1, 1913, if acquired before that date) divided by its probable life in years. Only such depreciation of farm buildings and equipment as is not offset by repairs may be deducted. Do not deduct repairs or depreciation of the dwelling you occupy, or of your personal or household equipment.

Do not claim as a separate item depreciation of live stock or any other property included in your inventory, as such depreciation is taken care of in the reduced amount of the inventory at the close of the year.

**Losses.**—You may deduct losses of buildings, machinery, and other property not included in your inventory, resulting from fires or other casualties and not compensated for by insurance or otherwise. Losses of property included in your inventory are taken care of by the reduced amount of the inventory at the close of the year.

**Automobile expense.**—You may deduct expenses of operation, repairs, and depreciation of automobiles used exclusively in the farm business. If an automobile is used in the farm business for a part of the time only, a corresponding part of the expense may be deducted.

**HOW TO FILL OUT THIS SCHEDULE**

Enter on pages 2 and 3 the amounts received from sales of farm crops, animals, and products, and the value of crops, animals, and products that were on hand at the beginning and end of the year. Go over the list of farm expenses on page 3 and enter the amount of each kind of expense separately so far as possible. Fill in the statement of repairs and depreciation of farm buildings, etc., on page 4.

In case you have complete farm records already summarized, enter the totals from your books in the spaces provided therefor.

When all the receipts and expenses have been entered, bring the various totals together in the summary on page 4. The figures inclosed in parenthesis are intended as a key to aid you in bringing forward the proper totals.

When you have determined the net farm income, transfer the amount to line 21 in Schedule A of the income tax return (Form 1040A or Form 1040).

While this schedule is intended to cover in detail only your income from the farm business, there are added at the bottom of page 4 spaces for making notes regarding income from other sources. Such income should be reported in detail in Schedules B to K of Form 1040A or Form 1040.

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### CROPS SOLD AND ON HAND

[illegible]

## LIVE STOCK BOUGHT, SOLD, AND ON HAND

[illegible]

CROP PRODUCTS SOLD AND ON HAND							EXPENSES		
Kind	On hand at beginning of year		Sold during year			On hand at end of year		Items	Amount
	Quantity	Inventory value	Quantity	Sale price		Quantity	Inventory value		
				Per unit	Total				
		\$			\$		\$	Hired labor (regular).....	\$
								Hired labor (extra).....	
								Board of hired labor.....	
								Cost of purchased materials furnished labor.....	
								Feed, hay, straw, etc.....	
								Feed, grain, concentrates.....	
TOTALS.....		\$			\$		\$	Feed grinding.....	
								Silo filling.....	
								Corn shredding.....	
								Cotton ginning.....	
								Milk hauling.....	
								Ice.....	
								Horseshoeing.....	
								Breeding fees.....	
								Veterinary fees.....	
								Seed, plants, etc.....	
								Fertilizers, manure.....	
								Spray materials.....	
								Twine.....	
								Threshing.....	
								Baling.....	
								Machine work hired.....	
								Fuel and oil for farm work.....	
								Barrels, bags, crates.....	
								Farm insurance.....	
								Taxes.....	
								Water rent.....	
								Cash rent.....	
								Interest on farm notes and mortgages.....	
								TOTAL.....	\$

  

LIVE STOCK PRODUCTS SOLD AND ON HAND						
Kind	On hand at beginning of year		Sold during year		On hand at end of year	
	Quantity	Inventory value	Quantity	Sale price	Quantity	Inventory value
		\$		\$		\$
Milk.....						
Butter.....						
Cream.....						
Cheese.....						
Eggs.....						
Wool.....						
Hides.....						
Honey.....						
TOTALS.....		\$		\$		\$

  

MISCELLANEOUS RECEIPTS	
DESCRIPTION	AMOUNT
Machine work, hire of teams, etc.....	\$
TOTAL.....	\$

  

INVENTORY OF SUPPLIES			
Kind	INVENTORY VALUE		
	At beginning of year	At end of year	
Purchased feeds.....	\$	\$	
Seeds.....			
Fertilizers.....			
Spray materials.....			
TOTALS.....	\$	\$	

## REPAIRS AND DEPRECIATION

DESCRIPTION	Cost of Property (or market value March 1, 1912)	REPAIRS	DEPRECIATION	
			Rate	Amount
Farm buildings	\$	\$		\$
Farm fences, drains, ditches, etc.				
Farm machinery and tools				
TOTALS	\$	\$	(18)	(19)

## SUMMARY

Amount received for farm products sold or exchanged		Farm expenses, etc.	
1. Crops (2)	\$	14. Cost of live stock purchased during year (5)	\$
2. Live stock (6)		15. Expenses (17)	
3. Crop products (9)		16. Repairs (18)	
4. Live stock products (12)		17. Depreciation (19)	
5. Miscellaneous (14)		18.	
6. Total receipts	\$	19. Total expenses, etc.	\$
Inventory value of farm crops, etc., at end of year		Inventory value of farm crops, etc., at beginning of year	
7. Crops (3)	\$	20. Crops (1)	\$
8. Live stock (7)		21. Live stock (4)	
9. Crop products (10)		22. Crop products (8)	
10. Live stock products (13)		23. Live stock products (11)	
11. Supplies (16)		24. Supplies (15)	
12. Total inventory at end of year	\$	25. Total inventory at beginning of year	\$
13. Total receipts plus inventory at end of year (Item 6 plus Item 12)	\$	26. Total expenses plus inventory at beginning of year (Item 19 plus Item 25)	\$
27. Net farm income to be reported in Schedule A, line 21, of Form 1040 A or Form 1040 (Item 13 minus Item 26)	\$		

## OTHER INCOME TO BE REPORTED ON RETURN (Form 1040 A or Form 1040)

DESCRIPTION	GROSS	DEDUCTIONS	NET
Income from salaries, wages, commissions, bonuses, director's fees, and pensions (to be reported in Schedule B)	\$	\$	\$
Income from partnerships, personal service corporations, and estates and trusts (to be reported as Item C)			
Income from sale of land, buildings, stocks, bonds, and other property (to be reported in Schedule D)			
Income from rents and royalties (to be reported in Schedule E)			
Interest on corporation bonds containing tax-free covenant, on which a tax of 2% was paid by debtor corporation (to be reported as Item F)			
Other income (to be reported in Schedule G)			
Dividends on stock of corporations organized or doing business in the United States (to be reported as Item K on Form 1040 A, or K(a) on Form 1040)			
Interest on obligations of the United States in excess of the exemptions allowed by law (to be reported as Item K(b), Form 1040)			

- 2 -

**Losses.—**

**REGULATION.** Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed. The total loss by frost, storm, flood or fire of a prospective crop, or of a crop which has not been sold, is not a deductible loss in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm. If live stock has been purchased for any purpose, and afterwards dies from disease, exposure or injury, or is killed by order of the authorities of a state or the United States, the actual purchase price of such stock, less any depreciation which may have been previously claimed with respect to such perished live stock, less also any insurance or indemnity recovered, may be deducted as a loss. The actual cost of other property, less depreciation already allowed, destroyed by order of the authorities of a state or of the United States may in like manner be claimed as a loss; but if reimbursement is made by a state or the United States, in whole or in part, on account of stock killed or property destroyed, the amount received shall be reported as income for the year in which reimbursement is made. In determining the cost of stock for the purpose of ascertaining the deductible loss there shall be taken into account only the purchase price, and not the cost of any feed, pasturage or care which has been deducted as an expense of operation. If gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. (Reg. No. 45, Article 145.)

It should be noted that farmers are entitled to the benefit of Section 204 and if a net loss is sustained in any taxable year, beginning after October 31, 1918, and ending prior to January 1, 1920, such net loss may be deducted in the preceding year or in the succeeding taxable year. Farmers, of course, if their fiscal year ended any date between January

and October, would not be entitled to the benefit of Section 204. Presumably most farmers make up their accounts on the basis of the calendar year, so that they will not be discriminated against, as is the case with many corporations.

## CHAPTER XXXII

### EXCESS AND WAR PROFITS TAXES

#### APPLICATION AND ADMINISTRATION— RETURNS, RATES, CREDITS

Page 692

**Advisory Tax Board.**—For composition of new board see page 1049.

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**Massachusetts trusts.**—In view of the fact that the decision in the case of *Malley v. Crocker*, has been reversed by the Supreme Court, Massachusetts trusts can not be held subject to the excess profits tax.

Page 697

#### **When net income is less than \$3,000.—**

**REGULATION.** The specific exemption of \$3,000 is apportioned only in the case where a return is made covering a period of less than twelve months. In such a case the specific exemption is the same proportion of \$3,000 as the number of months in the period is of twelve months, any part of a month being counted as a month. Thus, in the case of a corporation organized June 16, 1918, and making a return for the period ending December 31, 1918, the exemption is  $\frac{7}{12}$  of \$3,000, or \$1,750. This provision is inapplicable where the return is made for a full fiscal year beginning prior to January 1, 1918, and ending after that date, even though the income for such fiscal year is not subject to full taxation under the present statute. (Reg. No. 45, Article 761.)

COMPUTATION OF WAR AND EXCESS PROFITS TAX WHERE PART OF NET INCOME IS FROM GOLD MINING

Reg. 45, Art. 753

The computation is made first in the regular way, and then the proportion of the tax so calculated that the Net Income *not* from gold mining is to total income is the tax payable.

PAGES		SCHEDULE & ITEM
772-775	Average Pre-War Invested Capital.....	\$ 50,000.00 II-10
765-766	Average Pre-War Net Income.....	10,000.00 I-6
717-757	1918 Invested Capital.....	100,000.00 II-9
190, 391-392	1918 Net Income.....	40,000.00 I-7
<hr/>		
714	EXCESS PROFITS CREDIT	WAR PROFITS CREDIT
	8% of 1918 Invested Capital.....	Specific.....
	tal.....\$ 8,000.00 III-1	Pre-War Net Income.. 10,000.00 III-4
	Specific..... 3,000.00 III-2	Plus 10% of Increase
		in Invested Capital
		(\$100,000-\$50,000) .. 5,000.00 III-5
		<hr/>
		\$18,000.00 III-8
		<hr/>

## FIRST BRACKET

20% of 1918 Invested Capital (\$100,000).....	\$20,000.00	IV - 1 - Col. 2
Less: Excess Profits Credit.....	11,000.00	IV - 1 - Col. 3
At 30% .....	<u>\$ 9,000.00</u>	IV - 1 - Cols. 4, 5, 6

## SECOND BRACKET

1918 Net Income in excess of 20% of Invested Capital, at 65%.....	\$20,000.00	IV - 2 - Cols. 2, 4, 5, 6
	<u>\$15,700.00</u>	IV - 3 - Col. 6

## THIRD BRACKET

1918 Net Income.....	\$40,000.00	IV - 4
Less: War Profits Credit.....	18,000.00	IV - 5
At 80% .....	<u>\$22,000.00</u>	IV - 6, 7
Tax computed under first and second brackets.....	15,700.00	IV - 8
Amount of third bracket.....	<u>1,900.00</u>	IV - 9

Total Tax computed on entire Income.....

1918 Gross Income attributable to gold mining.....

Expenses attributable to gold mining.....

1918 Net Income attributable to gold mining (not taxable) .....

Income not attributable to gold mining.....

Total Net Income as above.....

Ratio of Net Income *not* from gold mining to total net income (\$25,000 to \$40,000) = 5/8; 5/8 of \$17,600 = Total Tax payable =.....



DELIVER OR SEND  
THIS RETURN  
TO COLLECTOR OF  
INTERNAL REVENUE  
ON OR BEFORE  
MARCH 15, 1919

IF EXTENSION OF  
TIME FOR FILING RETURN  
HAS BEEN GRANTED  
THE AUTHORIZATION  
MUST BE ATTACHED TO  
THIS RETURN

Page 1—Summary  
Form 1120—UNITED STATES INTERNAL REVENUE SERVICE  
**CORPORATION INCOME AND PROFITS TAX RETURN**  
FOR CALENDAR YEAR 1918

OR

Fiscal Period begun \_\_\_\_\_, and ended \_\_\_\_\_, 1918

It is hereby  
certified that  
the return  
has been  
prepared  
in accordance  
with the  
requirements  
of the  
Internal  
Revenue  
Act of 1913,  
as amended,  
and the  
regulations  
thereunder.

(Print plainly corporation's name and principal place of business)

Examined by

Audited by

(DO NOT WRITE IN THIS SPACE)  
PAYMENT  
CASH  
\$  
CHECK  
\$  
M. O.  
\$  
CERT. OF IND.  
\$  
(Cashier's Stamp)

## SCHEDULE I—NET INCOME.

Item.	1911	1912	1913
1. NET INCOME FOR EACH PREWAR YEAR (as finally determined on income returns).....	\$	\$	\$
2. Plus amount of corporation excise tax paid in each year.....	\$	\$	\$
3. TOTALS FOR 1911, 1912, AND 1913.....	\$	\$	\$
4. Less dividends received in 1913.....	\$	\$	\$
5. NET TOTAL FOR 1913.....	\$	\$	\$
6. AVERAGE NET INCOME FOR PREWAR PERIOD (sum of items on line 3 for 1911 and 1912 and item 5 for 1913, divided by number of years).....	\$	\$	\$
7. NET INCOME FOR TAXABLE YEAR (Item 25, Schedule A, page 2).....	\$	\$	\$

## SCHEDULE II—INVESTED CAPITAL.

Item.	1911	1912	1913	TAXABLE YEAR
1. Capital, surplus, and undivided profits at the close of the preceding year as shown by corporation's books before any adjustments are made therefrom (from Schedule F).....	\$	\$	\$	\$
2. Plus adjustments by way of additions (from Schedule F).....	\$	\$	\$	\$
3. TOTAL.....	\$	\$	\$	\$
4. Less adjustments by way of deductions (from Schedule G).....	\$	\$	\$	\$
5. BALANCE.....	\$	\$	\$	\$
6. Plus or minus changes in invested capital during year (from Schedules H and J).....	\$	\$	\$	\$
7. TOTAL (OR BALANCE).....	\$	\$	\$	\$
8. Less deduction on account of inadmissible assets (from Schedule I).....	\$	\$	\$	\$
9. INVESTED CAPITAL FOR EACH YEAR.....	\$	\$	\$	\$
10. AVERAGE INVESTED CAPITAL FOR PREWAR PERIOD (sum of items on line 9 for 1911, 1912, and 1913 divided by number of years).....	\$	\$	\$	\$
11. INCREASE OR DECREASE IN INVESTED CAPITAL FOR TAXABLE YEAR AS COMPARED WITH AVERAGE PREWAR INVESTED CAPITAL (Indicate decrease by "D").....	\$	\$	\$	\$

## SCHEDULE III—EXCESS-PROFITS AND WAR-PROFITS CREDITS.

If this return is made for a period less than a full year, items 3 and 8 must be reduced as provided in paragraph 1, page 1 of Instructions.)

Item.	1911	1912	1913
1. Eight per cent of invested capital for taxable year (Item 9, last column, Schedule II).....	\$	\$	\$
2. Exemption (\$5,000).....	\$	\$	\$
3. EXCESS-PROFITS CREDIT (Item 1 plus Item 2).....	\$	\$	\$
4. Average net income for prewar period (Item 6, Schedule I).....	\$	\$	\$
5. Plus 10% of increase or minus 10% of decrease shown by Item 1, Schedule II.....	\$	\$	\$
6. (a) TOTAL OF (OR DIFFERENCE BETWEEN) ITEMS 4 AND 5, or (b) 10% of invested capital for taxable year (Item 9, last column, Schedule II), whichever is larger.....	\$	\$	\$
7. Exemption (\$5,000).....	\$	\$	\$
8. WAR-PROFITS CREDIT (Item 6 plus Item 7).....	\$	\$	\$

## SCHEDULE IV—COMPUTATION OF TAXES.

WAR-PROFITS AND EXCESS-PROFITS TAX (Schedule one and two.)

(If this return is for a period less than a full year the invested capital must be reduced as provided in paragraph 1, page 1 of Instructions.)

1. BRACKET.	2. AMOUNT OF NET INCOME (Item 7, Schedule I) in Each Bracket.	3. EXCESS-PROFITS CREDIT (Item 3, Schedule III).	4. BALANCE SUBJECT TO TAX.	5. RATE.	6. AMOUNT OF TAX.
1. Not over 20% of invested capital.....	\$	\$	\$	20%	\$
2. Over 20% of invested capital.....	\$	\$	\$	65%	\$
3. TOTALS.....	\$	\$	\$		\$

## WAR-PROFITS AND EXCESS-PROFITS TAX (Bracket three.)

4. Net income for taxable year (Item 7, Schedule I).....	\$	7. Eighty per cent of Item 6.....	\$
5. Less amount of war-profits credit (Item 8, Schedule III).....	\$	8. Less Item 3 column 5 (if smaller than Item 7).....	\$
6. BALANCE.....	\$	9. TAX IN BRACKET THREE (Item 7 minus Item 8—If Item 8 is the larger, make no entry).....	\$
10. TOTAL WAR-PROFITS AND EXCESS-PROFITS TAX AS COMPUTED UNDER SECTION 301 (a) (Item 3 column 6 plus Item 9).....	\$		\$
11. TOTAL WAR-PROFITS AND EXCESS-PROFITS TAX, AS COMPUTED UNDER SECTION 302, 303, 304 (c) OR 337 (see Instructions, page 1, paragraphs 6 and 7).....	\$		\$

## INCOME TAX.

12. Net income for taxable year (Item 7, Schedule I).....	\$	17. Tax of 12% on Item 16.....	\$
13. Less interest on obligations of U. S. not exempt (Item 4, Schedule A, page 2).....	\$	18. Item 10 or Item 11 plus Item 17.....	\$
14. War-profits and excess-profits tax (Item 10 or 11).....	\$	19. Less income, war-profits, and excess-profits taxes paid or accrued to foreign countries on income arising from sources therein, and to possessions of the United States (see Sections 239 and 240 (c) of Revenue Act of 1918).....	\$
15. Exemption (\$4,000 unless notes in last line show a year).....	\$		\$
16. BALANCE SUBJECT TO INCOME TAX (Item 12 less Items 13, 14, and 15).....	\$		\$
20. TOTAL WAR-PROFITS, EXCESS-PROFITS, AND INCOME TAXES (except in case of a fiscal year) (Item 18 minus Item 19).....	\$		\$

## ADJUSTMENT OF TAX FOR FISCAL YEAR ENDED IN 1916.

21. That proportion of Item 20 which the number of months within the calendar year 1918 is of the number of months in the entire period.....	\$	23. Total tax (Item 21 plus Item 22).....	\$
22. That proportion of a tax computed under the revenue acts of 1916 and 1917 which the number of months within the calendar year 1917 is of the number of months in the entire period.....	\$	24. Less total tax already paid for the fiscal year ended in 1918.....	\$
25. TAX PAID: On submission of tentative return (1081 T).....	\$	25. BALANCE OF TAX.....	\$
26. Tax paid: On submission of tentative return (1081 T).....	\$	by remittance accompanying this return, \$.....	\$
		TOTAL.....	\$

## SCHEDULE A—TAXABLE NET INCOME.

Note.—Railroad corporations, banks, insurance companies, and other corporations required to submit statements of income and expenses to any national, State, municipal, or other public officer may submit instead of Schedule A a statement of income and expenses in the form in which submitted to such officer. In such cases the taxable net income will be recorded by means of Schedule B with the net profits shown by the income and expense statement submitted, and should be entered as Item 7, Schedule 1, page 1.

GROSS INCOME.									
1. Gross sales, less returns and allowances.....	\$.....								
2. Less cost of goods sold, exclusive of expenses, repairs, and other items called for separately below (from Schedule A2).....	\$.....								
3. Gross income from operations other than trading or manufacturing, less allowances (from Schedule A3).....									
4. Interest on obligations of the United States or its possessions not exempt (from Schedule A4).....									
5. Interest from other sources (from Schedule A5).....									
6. Rentals.....									
7. Royalties.....									
8. Share of net income earned since December 31, 1917, by personal service corporations (whether received or not).....									
9. Dividends on stock of foreign corporations (from Schedule A9).....									
10. Gross income from all other sources except dividends (not including any amount in respect of sales of capital assets or miscellaneous investments—see Item 23, below) (from Schedule A10).....									
11. TOTAL OF ITEMS 1 TO 10.....	\$.....								
DEDUCTIONS.									
12. Ordinary and necessary expenses (except amounts reported in Item 2 above or called for separately below, and not including cost or value of capital assets or miscellaneous investments sold during taxable year—see Item 23) (from Schedule A12).....									
13. Compensation of officers (including salaries, commissions, and other compensation in whatever form paid) (from Schedule A13).....									
14. Repairs (including labor, supplies, overhead, and other items properly chargeable to repairs) (from Schedule A14).....									
15. Interest (except on indebtedness incurred or continued to purchase or carry obligations or securities, other than obligations of the United States issued after September 24, 1917, the interest on which is wholly exempt from income tax).....									
16. Taxes (except Federal income, war-profits, and excess-profits taxes, taxes which are a credit under Section 236, and taxes assessed against local benefits of a kind tending to increase the value of the property assessed).....									
17. Debts ascertained to be worthless and charged off within the taxable year.....									
18. Exhaustion, wear and tear (including obsolescence) (from Schedule A18).....									
19. Amortization of war facilities (from Schedule A19).....									
20. Depreciation (if depletion is claimed, Form A (revised) of Mines and Minerals Section should be obtained from the Collector, filed in, and filed).....									
21. TOTAL OF ITEMS 12 TO 20.....	\$.....								
22. DIFFERENCE BETWEEN ITEMS 11 AND 21.....	\$.....								
23. Profit or loss on sales of capital assets and miscellaneous investments (from Schedule A23).....	\$.....								
24. Losses sustained during the taxable year from fire, storm, or other casualty, or from theft, not compensated for by insurance or otherwise (from Schedule A24) (extend in last column net total of Items 23 and 24).....	\$.....								
25. NET INCOME FOR TAXABLE YEAR (total of or difference between Item 22 and Item 24, last column) (to be entered as Item 7, Schedule 1, page 1).....	\$.....								

## SCHEDULE B—RECONCILIATION OF NET PROFIT PER BOOKS WITH TAXABLE NET INCOME.

1. Net profit for year per books, before any adjustments are made therein.....		5. Nontaxable income:	
2. Unallowable deductions:		(a) Interest on obligations of the United States and its possessions, wholly exempt.....	
(a) Donations, gratuities, and contributions.....		(b) Interest on obligations of States, Territories, and political subdivisions thereof.....	
(b) Interest, war-profits, and excess-profits taxes paid or accrued to the United States, its possessions, or a foreign country.....		(c) Interest on Farm Loan Bonds issued under Federal Farm Loan Act.....	
(c) Special improvement taxes.....		(d) Dividends on stock of domestic corporations.....	
(d) Furniture and fixtures, additions, or betterments treated as expenses on the books.....		(e) Dividends on stock of personal service corporations declared out of profits earned prior to Jan. 1, 1915.....	
(e) Replacements covered by depreciation.....		(f) Other items of nontaxable income (to be detailed).....	
(f) Insurance premiums paid on the life of any officer or employee for the benefit of the corporation or business.....		(g).....	
(g) Interest on indebtedness incurred or continued to purchase or carry obligations or securities other than obligations of the United States issued after September 24, 1917, the interest on which is wholly exempt from income tax.....		(h).....	
(h) Additions to reserves for bad debts, contingencies, etc. (to be detailed).....		(i).....	
(i).....		6. Charges against reserves for bad debts, contingencies, etc. (to be detailed).....	
(j).....		(a).....	
(k).....		(b).....	
(l).....		(c).....	
(m) Other unallowable deductions (to be detailed).....		(d).....	
(n).....		7. Amount necessary to adjust book profit to net with the amounts reported in Items 22 and 24, Schedule A (unless entry belongs on line 3).....	
(o).....		8. Taxable net income (Item 25, Schedule A).....	
3. Amount necessary to adjust book profit or loss with the amounts reported in Items 22 and 24, Schedule A (unless entry belongs on line 7).....			
4. TOTAL.....	\$.....	9. TOTAL.....	\$.....

## SCHEDULE C—BALANCE SHEETS.

Attach hereto balance sheets as of the beginning and end of the taxable year (preferably in parallel columns), showing as nearly as practicable the details called for below.

ASSETS.		LIABILITIES.	
Cash (including cash in bank and on hand, certificates of deposit, etc.).....	Deferred charges to future operations.	Notes Payable:	
Trade accounts and notes receivable (before deducting reserves for items).....	Fixed assets:	To other and nonexcludable:	
Other accounts and notes receivable (to be detailed).....	Buildings.....	To other (including bank loans).....	
Investments:	Equipment.....	Accounts Payable:	
Stocks.....	Tools and minor equipment.....	Trade.....	
Bonds.....	Delivery equipment.....	Other.....	
Real property.....	Other fixtures.....	Accrued expenses and reserves, the charges creating which are allowable deductions from income (to be detailed).....	
Intangible property.....	Other depreciable assets.....	Reserves for losses on notes and accounts receivable.....	
U. S. bonds and obligations (each item to be stated separately).....	Less reserves for depreciation.....	Reserves for contingencies, etc., the charges creating which are not allowable deductions from income (to be detailed).....	
U. S. Government securities.....	New York.....	Capital stock outstanding (to be detailed).....	
State bonds.....	Patents, good will, and other intangible assets:	Surplus and undivided profits.....	
State and municipal bonds.....	Patents.....		
Other.....	Good will.....		
Loans and advances:	Patents.....		
To officers and employees.....	On stock.....		
To others.....	Total.....		

A corporation having a net income of \$3,000 or more, which was in existence during at least one full prewar year, should also attach to this return similar balance sheets (preferably in parallel columns) as of the beginning of its first full prewar year and as of December 31, 1913.

## SCHEDULE D—ANALYSIS OF SURPLUS ACCOUNT.

Attach hereto an analysis of the corporation's surplus account, showing the details of all adjustments of surplus for the taxable year, as nearly as practicable in the following form.

1. Surplus at beginning of year per books.....	Deduct: 5. Dividends (state date payable and amount of each, and whether in cash or in stock).....
Add: 2. Total net profit per books and per Schedule B (Item 1).....	6. Other debits to surplus (to be detailed).....
3. Other credits to surplus (to be detailed).....	7. Surplus at end of year per books.....
4. Total of Items 1, 2, and 3.....	

A corporation having a net income of \$3,000 or more, which was in existence during at least one full prewar year, should also attach to this return a similar analysis of its surplus account for its first full prewar year and for each subsequent year down to the beginning of the taxable year.

**Page 2—Income Schedules—Continued**  
**SCHEDULES SUPPORTING SCHEDULE A**

The schedules called for below should be prepared and firmly stapled to this return. Designate each schedule with the number of the item in Schedule A which it explains. Make schedules on paper of uniform size as far as practicable. In the space provided for the purpose on page 6 list all schedules attached to this return, giving the title and schedule number of each.

**SCHEDULE A1: COST OF GOODS SOLD, EXCLUSIVE OF EXPENSES, REPAIRS, AND OTHER ITEMS CALLED FOR SEPARATELY.**

In support of Item 3, Schedule A, corporations engaged in manufacturing or trading operations will submit an analysis, in reasonable detail, of the cost of goods sold. This statement should ordinarily include the following items but should not include any expense items called for separately in Schedule A.

1. Inventories at beginning of period (to be reconciled with balance sheet).
2. Purchases during period.
3. Labor and wages ordinarily charged to manufacturing cost on the corporation's books, showing the principal items separately.
4. Other expenses ordinarily charged to manufacturing cost on the corporation's books. (State separately large or unusual items.)

**K. TOTAL**

- Deduct:
5. Inventories at close of period (to be reconciled with balance sheet).
  7. Cost of goods sold (Item 5 less Item 6).

NOTE.—Inventories should be valued at (a) cost or (b) cost or market, whichever is lower, provided, however, that whichever basis was adopted by a taxpayer for the taxable year 1917 must be continued unless upon application to the Commissioner permission is granted to change. If basis (b) is used it must be applied to each item in the inventory and not to a part only. Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. (See Articles 1581 to 1585 of Regulations No. 45.)

State here which of the above-mentioned bases for valuing inventories is used in this return.

**SCHEDULE A3: GROSS INCOME FROM OPERATIONS OTHER THAN TRADING OR MANUFACTURING, LESS ALLOWANCES.**

Submit a schedule showing the nature and amount of the principal items included in Item 3, Schedule A.

Life insurance companies should enter on Item 3, Schedule A, the total premiums received from policyholders less such portion thereof as has been paid back or credited to, or treated as an abatement of premiums of, such policyholders within the taxable year. (See Articles 546 and 547 of Regulations No. 45.)

Mutual marine insurance companies should report as Item 3, Schedule A, the gross premiums collected and received by them less amounts paid for reinsurance.

**SCHEDULE A4: INTEREST ON OBLIGATIONS OF UNITED STATES OR ITS POSSESSIONS NOT EXEMPT.**

Enter in table below the maximum amount of Liberty Bonds and other obligations of the United States issued since September 24, 1917 (par value) held at any one time, from which interest was derived during the taxable year:

1. CLASS OF OBLIGATION.	2. MAXIMUM AMOUNT OF INVESTMENT.	3. MAXIMUM EXEMPTION.
1a. First Liberty Loan converted into Second Loan and Second Liberty Loan converted into interest-redeemable Liberty Loan.		\$4,000 (None).
1b. First and Second Liberty Loans converted into Third Liberty Loan and Third Liberty Loan.		In addition to the \$4,000 in 1a, \$2,000 in 1b, and \$2,000 in 1c.
2. First Liberty Loan converted into Fourth Loan.		\$2,000.
3. Fourth Liberty Loan.		\$2,000.
4. Other obligations issued since September 24, 1917.		None.

NOTE.—This exemption as to items 1a and 1b (maximum \$45,000) is limited to one and one-half times the amount of bonds of the Fourth Liberty Loan originally subscribed for and still held. State that amount here.

In order to ascertain the amount to be entered as Item 4, Schedule A, refer first to the table above.

If the amount entered in column 2 of the table for any class of obligations exceeds the maximum exemption for the same class of obligations plus any part of the \$5,000 exemption assigned to that class (see column 3), attach hereto a schedule showing in separate columns the following information:

- (a) Class of obligations.
- (b) First and last dates of each period during which the corporation's holdings of that class of obligations remained unchanged.
- (c) Amount of obligations of that class held by the corporation during each such period.
- (d) Amount by which each amount entered in column (c) exceeds the maximum exemption for that class of obligations.
- (e) Rate of interest.

For interest derived from each amount of principal stated in column (d).

For the purpose of showing changes in holdings and applying the exemption, classes 1a and 1b must be taken jointly, but for the purpose of computing the taxable interest they must be entered separately.

Enter as Item 4, Schedule A, the total of column (f) for all classes of obligations. Submit also a statement showing the amount of interest derived from bonds and other obligations of the United States and its possessions, exclusive of those described in the table above.

**SCHEDULE A5: INTEREST FROM OTHER SOURCES.**

Submit a schedule showing the source, nature, and amount of the principal items included herein, the minor items being grouped in one figure. The total of the schedule should be entered as Item 5, Schedule A.

For interest on foreign bonds submit a schedule showing (a) name of country; (b) kind of obligations (whether national, state, municipal, or corporate obligations); (c) amount of principal; and (d) amount of interest.

**SCHEDULE A6: DIVIDENDS ON STOCK OF FOREIGN CORPORATIONS.**

Submit a schedule showing (a) name of corporation; (b) country in which organized; (c) total par value of stock held; and (d) amount of dividends.

**SCHEDULE A10: GROSS INCOME FROM ALL OTHER SOURCES EXCEPT DIVIDENDS (not including any amount in respect of capital assets or miscellaneous investments).**

Submit a schedule showing the source, nature, and amount of the principal items included herein, the minor items being grouped in one figure. The total of the schedule should be entered as Item 10, Schedule A.

**SCHEDULE A11: ORDINARY AND NECESSARY EXPENSES (except amounts called for separately in Schedules A and A2 and not including cost or value of capital assets or miscellaneous investments sold during taxable year).**

Submit a statement showing (a) character and amount of the principal items included in Item 11, Schedule A.

Insurance companies should state separately in Schedule A11 (a) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds; and (b) the total of sums other than dividends paid within the year on policy and annuity contracts.

Corporations issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan continuing for life and not subject to cancellation should report in Schedule A11 such part of the net addition (not required by law) made within the taxable year to reserve funds as is required for the protection of the holders of such policies.

Mutual marine insurance companies should report in Schedule A11 amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the accrualment and the payment thereof.

Mutual insurance companies (other than mutual life and mutual marine insurance companies) that require their members to make premium deposits to provide for losses and expenses should report in Schedule A11 the amount of premium deposits returned to their policyholders and the amount of premium deposits retained on account of losses, expenses, and reinsurance reserve (unless deducted elsewhere in Schedule A).

**SCHEDULE A13: COMPENSATION OF OFFICERS.**

Submit a schedule showing for each officer (1) name, (2) duties, (3) time devoted to such duties, (4) shares of stock owned, (5) total annual compensation for the years 1916, 1917, and 1918, and (6) reasons for increases.

**SCHEDULE A14: REPAIRS (including labor, supplies, overhead, and other items properly chargeable to repairs).**

Submit a schedule showing the nature and amount of the principal items included in Item 14, Schedule A.

Incidental repairs, which do not add to the value or appreciably prolong the life of property, are deductible as expenses. Expenditures for new buildings or for permanent improvements or betterments which increase the value of the property are chargeable to capital account. Expenditures for restoring or replacing property are not deductible under this or any other item of the return. Such expenditures are chargeable to capital account or to depreciation reserve, depending on the treatment of depreciation on the books of the taxpayer.

**SCHEDULE A15: EXHAUSTION, WEAR AND TEAR (including obsolescence).**

Submit a columnar schedule containing, in the most profitable form, substantially the following information:

1. A classification of depreciable assets subdivided on the basis of (a) character, (b) term of useful life.
2. The fair market value of such assets March 1, 1913, if acquired before that date.
3. The cost of such assets if acquired after February 23, 1913.
4. The estimated life or term of reasonable usefulness of such assets from date acquired or from March 1, 1913, as the case requires. Give reasons for your conclusions.

**5. For each class of assets state—**

- (a) The total amount of depreciation from March 1, 1913, to the beginning of the taxable year.
- (b) The total amount of depreciation (exhaustion, wear and tear, including obsolescence) claimed for the taxable year.

6. A reconciliation of all figures shown in this schedule with corresponding figures reflected in the balance sheets.

**SCHEDULE A19: AMORTIZATION OF WORKING FACILITIES.**

If amortization of working facilities is claimed the taxpayer is required to submit with this return the information and schedules called for in Articles 181 to 187 of Regulations No. 45.

**SCHEDULE A22 AND A24: PROFIT OR LOSS ON SALES OF CAPITAL ASSETS AND MISCELLANEOUS INVESTMENTS, AND LOSSES SUSTAINED DURING THE TAXABLE YEAR FROM FIRE, STORM, OR OTHER CAUSALTY, OR FROM THEFT, NOT COMPENSATED FOR BY INSURANCE OR OTHERWISE.**

Submit a columnar schedule setting forth for each sale of capital assets or of miscellaneous investments and for each loss during the taxable year the information called for below:

1. Description of property sold or of property in respect of which a loss is claimed.
2. Date acquired.
3. Fair market price or value on March 1, 1913, if acquired before that date, or cost if acquired after February 23, 1913.
4. Cost of improvements, if any, since February 23, 1913, or since date of acquisition, if acquired after February 23, 1913.
5. Total of Items 3 and 4.

**Loss—**

6. Depreciation or depletion of property subject thereto—
  - (a) For books.
  - (b) Accrued but not on books.
7. Salvage value, if any, of property on which a loss is claimed.
8. Amount of insurance or other recovery on property, if any.
9. Proceeds of sale or cash value of property received in exchange (for transactions falling in Item 23, Schedule A) (see Note).
10. Total of Items 6 to 9, inclusive.
11. Profit or loss.
12. Cause of loss (for losses falling in Item 24, Schedule A).

NOTE.—Submit evidence substantiating the basis used by you in arriving at the cash value of property received in exchange for other property.

**COMPENSATION AT RATE OF \$2,000 OR MORE PER ANNUM.**

Submit a schedule showing for each employee (if a stockholder of the corporation, whose compensation is at the rate of \$2,000 or more per annum, facts similar to those called for in Schedule A15.

**WORKING PAPERS.**

Every corporation should preserve, available for inspection by a revenue officer, working papers showing—

1. The balance in each account on the corporation's books that was used in preparing Schedule A.
2. The amount deducted from each such balance on account of each class of non-taxable income, allowable deductions, and other adjustments indicated in Schedule B, with a reference to the number of the item in Schedule B in which each such amount so deducted was included.
3. The remainder of each such balance, analyzed to show the amount included in each item of Schedule A, with a reference to the number of the item in Schedule A in which each such amount was included.

**SCHEDULE E—CAPITAL, SURPLUS, AND UNDIVIDED PROFITS AS SHOWN BY BOOKS BEFORE ANY ADJUSTMENTS ARE MADE THEREIN.**

Ex. Stock actually outstanding at the end of the preceding taxable year should be entered in this schedule to the extent that it is paid up. If stock or shares were issued at a nominal value or without par value, the entries should reflect the amounts on the books in respect thereof at the close of the preceding taxable year.

Ex. This item should include paid-in surplus per books at the end of the preceding year. If any amount is claimed under Section 336(e)(3) of the Revenue Act of 1918 or under Article 891 of Regulations 45 the amount claimed should be entered under Item 1, Schedule F, and not in this schedule.

Item.	1911	1912	1913	TAXABLE YEAR.
Capital stock paid up and actually outstanding at the close of the preceding year.				
1. First preferred.....				
2. Second preferred.....				
3. Common.....				
4. TOTAL.....				
Surplus and undivided profits:				
5. Paid-in surplus.....				
6. Earned surplus and undivided profits				
7. Reserves, additions to which are not deductible in computing net income (to be reconciled with balance-sheet reserves)				
8. GRAND TOTALS OF ITEMS 4, 5, 6, AND 7.....				
9. Deduct cost of treasury stock (or book value if different from cost), if any is included above as outstanding.....				
10. NET TOTAL (Item 8 minus Item 9).....				

**SCHEDULE F—ADJUSTMENTS BY WAY OF ADDITIONS.**

Fr. If an addition to invested capital is claimed in Item 1, Schedule F, submit a statement showing (a) the kind of property, (b) the year in which it was paid in, (c) from whom acquired, explaining its relationship to the corporation, (d) the actual cash value of such property at the date when paid in, (e) the par value of stock or shares issued therefor and the amount at which such property is entered in the accounts, and (f) the basis upon which the actual cash value of the property was determined and the date when such determination was made.

Fa. If an addition to invested capital is claimed in Item 2, Schedule F, submit a statement showing (a) the kind of property, (b) the year in which it was acquired, (c) the cost, (d) the amount of depreciation sustained on such property from the date of acquisition to the beginning of the taxable year. State also whether each item sought to be restored was actually used or usable at the beginning of the

taxable year. Were these expenditures, when made, written off in lieu of depreciation?..... If so, explain what adjustments have been made to provide for depreciation in view of the proposed restoration to surplus.

Fg. If any addition to invested capital is claimed in Item 3, Schedule F, state specifically the amount of depreciation written off each year in the books of the company, and the amount allowed as a deduction in computing net income.

Fh. If any assets of the trade or business in existence during both the taxable year and any prewar year are included in the invested capital for the taxable year but not for such prewar year, or are valued on a different basis in computing the invested capital for the taxable year and such prewar year, entries should be made in this schedule adjusting the invested capital for each prewar year affected so as to value such assets upon the same basis in the prewar period as in the taxable year.

Item.	1911	1912	1913	TAXABLE YEAR.
1. Actual cash value of tangible property clearly and substantially in excess of par value of such property and of the cash or other consideration paid therefor (Article 840 and 841).....				
2. Additions to surplus (Articles 840 to 843).....				
3. Depreciation charged in the accounts of the corporation but not allowable as a deduction on income tax returns.....				
4. Adjustment of valuation of assets in excess of par value both during taxable year and in prewar period (Article 844).....				XXX XXX XXX XX
5.....				
6.....				
7.....				
8. TOTAL.....				

**SCHEDULE G—ADJUSTMENTS BY WAY OF DEDUCTIONS.**

Gr. Is any patent, copyright, secret process or formula, good will, trade-mark, trade brand, franchise, or other similar intangible property, paid for, stock entered on the books of the corporation at a value in excess of its actual cash value when paid in?..... In excess of the par value of the stock issued therefor?..... Is the aggregate of such assets acquired prior to March 3, 1917, entered on the books at a value in excess of 25 per cent of the par value of the stock outstanding on March 3, 1917?..... Is the aggregate of such assets entered on the books at a value in excess of 25 per cent of the par value of the stock outstanding at the beginning of the taxable year?.....

If the answer to any of the foregoing questions is "yes" submit a statement showing separately with respect to such assets acquired (1) before March 3, 1917, and (2) on or after that date: (a) Date of acquisition; (b) cash value at that date, with a complete explanation of the basis upon which such value was determined; (c) par value of the stock issued therefor; (d) par value of total stock outstanding March 3, 1917; (e) par value of total stock outstanding at the beginning of the taxable year; (f) the value at which such assets are entered on the books of the corporation.

If all the intangibles were acquired before March 3, 1917, the amount by which (f) exceeds (b), (c), 25 per cent of (d), or 25 per cent of (e), whichever is lowest, must be entered as Item 1, Schedule G, for the taxable year and for each year of the prewar period that is affected.

If the intangibles were acquired on or after March 3, 1917, the amount by which the entry in (f) relating to such intangibles exceeds (b) or (c) relating thereto, or 25 per cent of (d), whichever is lowest, must be included in Item 1, Schedule G, for the taxable year. Provided, that if intangibles were acquired before March 3, 1917, and also on or after that date, deduction shall be made so that the amount included in invested capital for the aggregate of intangibles shall not exceed 25 per cent of the par value of the total stock outstanding at the beginning of the taxable year.

Norm.—If the stock of the corporation was issued at a nominal value or without par value, for the purpose of the computation under Item 1 the par value shall be deemed to be the fair market value as of the date of issue. The aggregate value so determined of stock March 3, 1917, or at the beginning of the taxable year, shall be the basis for the computation.

Ga. Is any tangible property, paid in for stock, entered on the books of the corporation at a value in excess of its actual cash value when received?..... In excess of the par value of the stock paid therefor?.....

If the answer to either of the foregoing questions is "yes" submit a statement showing (a) kind of property; (b) when acquired; (c) par value of the stock paid therefor; (d) actual cash value of the property when received; (e) the basis on which that value was determined; (f) value at which the property is entered on the corporation's books; and (g) amount by which such value exceeds the allowable value under section 214 of the Revenue Act of 1918. This amount as Item 1, Schedule G, for the taxable year and for each year of the prewar period that is affected.

Gp. (a) Was any stock issued by the corporation over, returned as a gift or for a consideration substantially less than its par value?..... (b) If so, what was the total par value of such stock?..... (c) What was the consideration paid for the return thereof?..... (d) What amount of cash or its equivalent was de-

rived from the resale of such stock?..... (e) What entries were made in the accounts to evidence the return and the resale of such stock?.....

The excess of (b) over (d) must be entered as Item 3, Schedule G, for the taxable year and for each year of the prewar period that is affected. If no entry or deduction is necessary if adequate adjustment has been made under Item 2 of this schedule.

Gq. Was the business reorganized or consolidated or was its ownership changed or was there a change in ownership of property after March 3, 1917?..... If so, answer the following questions:

(a) Did an interest of 50 per cent or more in the business or in the property which changed ownership remain in the control of the same persons, corporations, associations, or partnerships, or of any of them?.....

(b) Were any of the assets entered on the books of the corporation making this return at a higher value than on the books of its predecessor?.....

(c) If such previous owner was not a corporation attach a statement showing (1) the cost of acquisition to the previous owner of any asset so transferred or received; (2) expenditures subsequent to that date for betterment or development, not deducted as expense or otherwise since March 1, 1913, by such previous owner; (3) the allowance for depreciation, depletion, or impairment since the date of acquisition by such previous owner.

(d) If all, or substantially all, of the property was acquired from a corporation during the taxable year attach hereto balance sheets of such predecessor corporation as of the beginning of the taxable year and as of the date immediately prior to the transfer of the property to the corporation making this return, and also a balance sheet or statement of the corporation making this return showing the values at which such property received or transferred was entered on the books.

The increase in book value of any property acquired by reorganization, consolidation, or change of ownership, over the amount allowable to the predecessor corporation or over the amount so computed under (c), if the previous owner was not a corporation, must be deducted from the invested capital for the taxable year as Item 4, Schedule G.

Gg. Is any property (including physical property, securities, and intangible property) paid for with cash or with other tangible property entered on the books of the corporation at a value in excess of the amount of cash paid therefor or the actual cash value of the tangible property paid therefor?..... If so, submit a statement showing (a) kind of property; (b) amount of cash paid therefor; (c) actual cash value of other tangible property paid therefor; (d) how that value was determined; (e) value at which the property is entered on the books of the corporation; and (f) excess of (d) over (b) or (c). This excess must be entered as Item 5, Schedule G, for the taxable year and for each year of the prewar period that is affected.

Gd. Has adequate provision been made in the expense accounts of the company for (a) losses of every kind?..... (b) depreciation?..... (c) obsolescence?..... (d) depletion of mineral deposits, timber supplies, and the like?..... If adequate charge has not been made for depreciation, depletion, obsolescence, and other losses, and the value of the property has not been maintained by replacements that have been charged to expense, proper additional charges therefor must be computed for all years in which they were not made on the books, and the total amount of such charges must be entered as Item 6, Schedule G, for the taxable year (and for each year of the prewar period that was affected) and deducted in arriving at the surplus and undivided profits.

**Page 5—Invested Capital Schedules—Continued**  
**SCHEDULE G—ADJUSTMENTS BY WAY OF DEDUCTIONS (Concluded).**

ITEM.	1911	1912	1913	TAXABLE YEAR
1. Valuation of patents, copyrights, secret processes or formulas, good will, trade marks, trade names, franchises, or other intangible property	\$	\$	\$	\$
2. Valuation of tangible property paid in for stock				
3. Stock returned to the corporation as a gift, etc.				
4. Valuation of assets acquired in reorganizations				
5. Appreciation				
6. Depreciation and depletion				
7.				
8.				
9. TOTAL DEDUCTIONS	\$	\$	\$	\$

**SCHEDULE H—CHANGES IN INVESTED CAPITAL DURING TAXABLE YEAR.**

1. Changes in invested capital during the taxable year ordinarily arise in one or more of the following ways:

- Additions by reason of the sale of capital stock or the issue of capital stock for tangible or other assets.
- Liquidation of part of the capital by retirement of stock or purchase of treasury stock not out of current earnings.
- Payment of cash dividends out of earnings of prior years.
- Deduction of the amount of Federal income and excess-profits taxes for the previous year.
- Payment of assessments by stockholders, or creation of paid-in surplus by contribution of stockholders.

Specify (by using red ink for distributions, or otherwise) whether each item represents an addition or a distribution.

2. Report dividends paid out of profits of prior years but not dividends paid out of profits of the taxable year. Any distribution made during the first 60 days of the taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; but any distribution made during the

3. If stock is issued for cash, the actual cash received (but not the amount of discount) should be entered in this schedule. Assets (other than cash) paid in for stock must be valued in accordance with Section 325 (a) (2) of the Revenue Act of 1918.

4. The amount of Federal income and excess-profits taxes payable should be deducted as of the date when due and payable whether reserves have been set up on the books or not. (See Article 545.)

5. If capital stock of the corporation is reacquired but not paid for out of current profits, the cost of such stock should be deducted from invested capital.

6. The data called for in columns 1 to 5 should be given for all transactions, except that columns 3 and 4 are applicable only to the issue or reacquisition of the corporation's stock.

7. In Column 6 enter the number of days remaining in the taxable year (including the date of change).

8. The net changes, if not in accordance with the increases or decreases reflected in the balance sheets, should be fully reconciled therewith.

1. NATURE OF ADDITIONS AND DISTRIBUTIONS.	2. DATE.	3. NUMBER OF SHARES SOLD OR REACQUIRED.	4. IF FOR CASH, STATE PRICE PER SHARE.	5. AMOUNT OF CASH OR CASH VALUE ACTUALLY RECEIVED OR PAID OUT.	6. NUMBER OF DAYS EXISTENT.	7. ADJUSTED AVERAGE (Column 3 x Column 6) Number of days in taxable year
1.			\$	\$		
2.						
3.						
4.						
5.						
6.						
7.						
8.						
9.						

**SCHEDULE J—CHANGES IN INVESTED CAPITAL DURING PREWAR YEARS.**  
 (Compute the net addition or reduction separately for each year. See instructions under Schedule H.)

1. NATURE OF ADDITIONS AND DISTRIBUTIONS.	2. DATE.	3. NUMBER OF SHARES SOLD OR REACQUIRED.	4. IF FOR CASH, STATE PRICE PER SHARE.	5. AMOUNT OF CASH OR CASH VALUE ACTUALLY RECEIVED OR PAID OUT.	6. NO. OF DAYS EXISTENT.	7. ADJUSTED AVERAGE (Column 3 x Column 6) Number of days in year.
1.			\$	\$		
2.						
3.						
4.						
5.						
6.						
7.						
8.						
9.						
10.						
11.						
12.						
13.						
14.						

**SCHEDULE K—CHANGES IN INVESTED CAPITAL FROM END OF PREWAR PERIOD TO BEGINNING OF TAXABLE YEAR, NOT SHOWN IN SCHEDULE E.**  
 (See instructions under Schedule H, so far as applicable.)

1. NATURE OF ADDITIONS AND DISTRIBUTIONS.	2. DATE.	3. NUMBER OF SHARES SOLD OR REACQUIRED.	4. IF FOR CASH, STATE PRICE PER SHARE.	5. AMOUNT OF CASH OR CASH VALUE ACTUALLY RECEIVED OR PAID OUT.
1.			\$	\$
2.				
3.				
4.				
5.				
6.				
7.				
8.				
9.				
10.				
11.				
12.				
13.				
14.				

# Page 6—Invested Capital Schedules (Concluded) and Questions.

## SCHEDULE L—INADMISSIBLE ASSETS.

Has the corporation any inadmissible assets (i. e., stocks, bonds, and other obligations, except obligations of the United States, the income from which is not taxable)?

If so, attach hereto a statement showing for 1911, 1912, 1913, and the taxable year, separately, the facts called for in items (e) to (j) of this schedule.

If the income from such assets consists in part of gain or profit from the sale or other disposition thereof, or if all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under Section 234 (a) (3) of the Revenue Act of 1913, then a corresponding part of the capital invested in such assets is deemed an inadmissible asset. In such case, set forth in detail—

(e) The various kinds of income derived from such assets and the computation of the part of the capital invested therein which is deemed an inadmissible asset.

For the purpose of this schedule, inadmissible assets shall be valued at cost of acquisition except that if the taxpayer has in previous years been allowed a deduction on account of the fall in the market value of securities, such assets shall be valued at cost less the deduction allowed. Admissible assets shall be valued as provided in Sections 236, 230, and 231 of the Revenue Act of 1913 and Articles 331-408, 951-994, and 941 of Regulations 45. The average amount of assets of each kind held during any year may ordinarily be determined by dividing by 2 the sum

of the amount of such assets held at the beginning of the year and the amount held at the end of the year. In such case the amount of admissible assets may best be determined from (1) the balance sheet as of the beginning of the year adjusted with respect to the items in Schedules F and G, and (2) the balance sheet as of the end of the year correspondingly adjusted. But if at any time during the year a substantial change has taken place in the amount of such assets, the average amount must be determined as provided in Article 852 of Regulations 45. In such case, show in detail—

(b) The computation of such amount.

State also—

(c) Amount of inadmissible assets held at beginning of the year.

(d) Amount of inadmissible assets held at end of year.

(e) Average amount of inadmissible assets held during year.

(f) Amount of admissible assets held at beginning of the year.

(g) Amount of admissible assets held at end of year.

(h) Average amount of admissible assets held during year.

(i) Sum of (e) plus (h).

(j) Percentage which (e) is of (i).

This percentage (j) for each year should be applied to the figures for that year appearing on line 7, Schedule II, in order to obtain the deduction on account of inadmissible assets, which should be entered on line 8, Schedule II.

## QUESTIONS

### AFFILIATIONS WITH OTHER CORPORATIONS (TO BE ANSWERED BY EVERY CORPORATION)

11. Do you own directly or control through closely affiliated interests or by a nominee or nominees over 50 per cent of the outstanding capital stock of another corporation or of other corporations?

12. Is over 50 per cent of your capital stock owned by another corporation or by two or more corporations that are affiliated?

13. Is over 50 per cent of your capital stock as well as over 50 per cent of the capital stock of another corporation or of other corporations owned or controlled by the same individual or partnership or by the same individuals or partnerships?

14. Is this return a consolidated return within the meaning of Articles 631 to 628, inclusive, of Regulations 45?

15. Affiliated corporations as indicated in 11, 12, or 13 above must comply with the following requirements:

16. If the answer to question 11 is "yes," submit a statement showing for each of the corporations over 50 per cent whose stock is owned or controlled by you, either directly or through closely affiliated interests or by a nominee or nominees:—

(a) The name and address;

(b) The total par value of the outstanding capital stock at the beginning of the taxable year, and the date and amount of each change therein;

(c) The total par value of such outstanding capital stock owned or controlled by you at the beginning of the taxable year, or at the date of acquisition if acquired during the taxable year, and the date and amount of each change therein.

17. If the answer to question 12 is "yes," state—

(a) The name and address of such corporation or corporations;

(b) The par value and percentage of your stock held by each.

18. If the answer to question 13 is "yes," submit a statement showing—

(a) The names and addresses of such corporations;

(b) The name or names and address or addresses of the owning or controlling interest or interests;

(c) The total par value of the outstanding capital stock of each corporation at the beginning of the taxable year, and the date and amount of each change therein;

(d) The total par value of the outstanding capital stock of each corporation owned or controlled by each one of the several individuals or partnerships at the beginning of the taxable year, and the date and amount of each change therein.

19. If the answer to question 14 is "yes," the information furnished under 16 and 18 should identify the corporations included in the consolidation.

20. If one corporation owns 95 per cent or more of the stock of another, or if 95 per cent or more of the stock of two or more corporations is owned by the same individual or individuals in substantially the same proportion, a consolidated return must be filed, except that the limitation as to consolidation under Article 635 must be observed. If the ownership is less than 95 per cent, but exceeds 50 per cent, the parent corporation or principal corporation of any group of affiliated corporations must furnish the information called for above and in addition must file a statement fully disclosing the details of affiliation other than stock ownership and all other information which will be helpful in determining whether or not a consolidated return should be filed.

### VALUATION OF CAPITAL STOCK.

21. What was the fair value of the total capital stock of the corporation as determined in the last assessment of the capital stock tax (if any)? \$

Date of that assessment.

### LIST OF ATTACHED SCHEDULES.

Make below a list of all schedules attached to this return, giving for each a brief title and the schedule number.

## INCORPORATION.

5. Date of incorporation.

6. Under the laws of what State or country?

### PREDECESSOR BUSINESSES.

7. If the corporation was not in existence during the whole of any one of the calendar years 1911-1913, is its business substantially a continuation of a business carried on during any one or more of those years? If so, give name under which, and address at which, its business was then carried on

### ACQUISITION OF MIXED AGGREGATES OF ASSETS.

8. Did the corporation ever take over a going business or otherwise acquire a mixed aggregate of tangible property, patents and copyrights, and good will and other similar intangible property, and pay for such property in whole or in part with stock or other securities?

9. If so, submit a statement showing—

(a) The name of the concern taken over (or from which the property was acquired);

(b) The nature of the assets and liabilities so acquired;

(c) The total par value of the stock issued therefor;

(d) The value at which each class of assets was carried on the books of the concern from which acquired (if obtainable submit a balance sheet of the predecessor corporation as of the date of acquisition);

(e) The value at which each item was entered on the books of the corporation making this return.

10. If patents, copyrights, secret processes or formula, good will, trade-marks, trade brands, franchises, or other intangible property were acquired, state also the basis on which their value was determined and how they were paid for.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself depose and says that this return, including the accompanying schedules and statements, has been examined by him and is to the best of his knowledge and belief a true and complete return made in good faith pursuant to the Revenue Act of 1913 and the Regulations issued thereunder.

Sworn to and subscribed before me this day of 19

Not a public officer taking affidavit.

(Official Capacity.)

President.

Treasurer.

## INSTRUCTIONS REGARDING DETERMINATION OF CREDITS, COMPUTATION OF TAX, ETC.

## PROVISIONS AFFECTING INVESTED CAPITAL AND CREDITS.

## RETURNS FOR PART OF A YEAR.

1. If this return is for a period less than a full year, Items 8 and 8, Schedule III; Items 1 and 2, column 2, Schedule IV; and Item 15, Schedule IV, shall be reduced to as many twelfths of the figures for a full year as there are months in the period for which the return is made.

If the period for which the return is made includes fractions of months, there shall be added to the number of complete months as many thirtieths of a month as there are days in the fractional parts of months.

## CORPORATIONS NOT IN EXISTENCE DURING PREWAR PERIOD.

2. If a corporation was not in existence during the whole of at least one calendar year in the prewar period, provided a majority of its capital stock was not owned or controlled, directly or indirectly, at any time during the taxable year by a corporation in existence during the whole of at least one calendar year in the prewar period, and provided its gross income does not include 50 per cent or more of gains, profits, commissions, or other income derived from a Government contract or contracts made after April 5, 1917, and before November 12, 1918, the war-profits credit shall be (a) the sum of \$3,000 plus (b) the same percentage of the invested capital for the taxable year (not less than 10 per cent, however) as the average per cent of net income to invested capital for the prewar period of corporations engaged in a trade or business of the same general class as the taxpayer.

3. Pending a determination of the deduction by the Commissioner, such corporation shall deduct 10 per cent of the invested capital for the taxable year. (See Section 311 (c), (d) of the Revenue Act of 1918 and Articles 783 and 784 of Regulations 45.)

## CREDIT FOR INCOME, WAR-PROFITS, AND EXCESS-PROFITS TAXES PAID OR ACCRUED TO FOREIGN COUNTRY OR POSSESSION OF THE UNITED STATES.

4. If a credit is claimed in Item 19, Schedule IV, a copy of Form 1118, completely filled out and sworn to or affirmed, must be submitted with this return. If credit is sought for taxes already paid the form must have attached to it the receipt for each such tax payment. If credit is sought for taxes accrued the form must have attached to it the return on which each such accrued tax was based. (See Article 611 of Regulations 45.)

5. When a credit is claimed for accrued taxes, the Commissioner may, as a condition precedent to the allowance of this credit, require the corporation to give a bond (Form 1119), with sureties satisfactory to and to be approved by him, in such penal sum as he may require, conditioned for the payment by the taxpayer of any amount of taxes found due if the taxes when paid differ from the amount claimed in respect thereof.

## PROVISIONS AFFECTING COMPUTATION OF WAR-PROFITS AND EXCESS-PROFITS TAX.

6. Item 10, Schedule IV, is the war-profits and excess-profits tax, unless the taxpayer is entitled to the benefits of one or more of the following provisions:

(a) **Limitation on total tax.**—The maximum war-profits and excess-profits tax imposed shall in no case be more than 30 per cent of the net income in excess of \$3,000 and not in excess of \$20,000 plus 80 per cent of the net income in excess of \$20,000 (Sec. 302).

(b) **Tax on profits from sale of mineral deposits.**—In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the war-profits and excess-profits tax attributable to such sale shall not exceed 20 per cent of the selling price of such property or interest. (See Articles 971 and 972 of Regulations 45, and section 337 of the Act.)

(c) **Tax of corporation engaged in mining of gold.**—If a corporation was engaged in the mining of gold, its war-profits and excess-profits tax shall be that proportion of Item 10, Schedule IV, which the net income not derived from the mining of gold bears to the total net income (Articles 752 and 753 of Regulations 45—Sec. 304).

(d) **Tax of corporation whose income is derived in part from "personal service."**—If part of the net income (not less than 30 per cent) is derived from a separate trade or business of the character of "personal service," the tax shall be computed in accordance with the provisions of Articles 741 to 743 of Regulations 45 (Sec. 303).

7. **Statement of basis of claims.**—If the corporation claims the benefit of one or more of these provisions, it should attach to the return a complete statement of the basis for such claim and a computation of the tax payable in the event that such claim is allowed. The amount of tax so computed should be entered as Item 11, Schedule IV, but, except in cases falling under (a) above, the taxpayer must nevertheless fill out all the schedules of this form.

## SPECIAL CASES.

8. **Definition of special cases.**—Section 327 of the Act provides that in the following cases the tax shall be determined as provided in section 328:

(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;  
(b) In the case of a foreign corporation;  
(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

(d) Where, upon application by the corporation the Commissioner finds and declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profits upon a normal invested capital nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive.

9. **Treatment of special cases.**—In the cases specified in section 327 the tax will be specially determined under the provisions of section 328, but the tax will not ordinarily be computed under section 328 merely because the corporation's form or manner of organization, or the limitations imposed by section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) of section 327 (paragraph 8, above) may make application for assessment under the provisions of section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the prewar period; and (e) a statement showing the amount of gains, profits, commissions or other income derived on a cost-plus basis from Government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. (See Article 901.)

10. **Determination of first installment of tax in special cases.**—In the case of a foreign corporation, and in the case of any other corporation where absolutely no data are available for the determination of the invested capital for the taxable year, the installments of the tax shall, in the first instance, be computed and the first installment paid upon the basis of a tax equal to 50 per cent of the net income. In any other case under section 328, including a case where the invested capital for the taxable year can not be accurately determined, but where a minimum amount of invested capital as to which there is no question can be determined, the installments shall in the first instance be computed and the first installment paid upon the basis of a tax upon the minimum amount of invested capital, not, however, exceeding a tax upon the basis of 80 per cent of the net income. In any of the above cases the actual ratio when ascertained by the Commissioner will be used in determining the correct amount of the tax. (See Section 912.)

11. **Returns in special cases.**—Corporations other than foreign corporations making claim for assessment under section 328 of the Act should answer all questions and fill all schedules as far as possible and attach a statement explaining why it is impracticable to fill out the entire return.

## UNDISTRIBUTED PROFITS TAXABLE TO STOCKHOLDERS.

12. If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders or members through the medium of permitting its gains or profits to accumulate instead of being divided or distributed, such corporation shall not be subject to the tax imposed by section 230 of the Revenue Act of 1918, but the stockholders or members thereof shall be subject to taxation under Title 2 in the same manner as in the case of stockholders of a personal service corporation, except that the tax imposed by Title 3 of the Revenue Act of 1918 shall be deducted from the net income of the corporation before the proportionate share of each stockholder or member is computed (Section 220, Article 351).

## LOSS ON INVENTORIES AND REBATES UPON SALES.

13. At the time of filing returns for the taxable year 1918, a claim for abatement may be filed based on the fact that a substantial loss has been sustained (whether or not actually realized by sale or other disposition) resulting from any material reduction (not due to temporary fluctuation) in the value of the inventory as at the end of such taxable year, or from the actual payment after the close of such taxable year of rebates in pursuance of contracts entered into during such year upon sales made during such year. In such case payment of the amount of the tax covered by such claim shall not be required until the claim is decided, but the taxpayer shall accompany his claim with a bond in double the amount of the tax covered by the claim, with sureties satisfactory to the Commissioner, conditioned for the payment of any part of such tax found to be due, with interest at the rate of 1 per cent per month.

14. If no such claim is filed with the return, but it is shown to the satisfaction of the Commissioner that during the taxable year 1918 the taxpayer has sustained a substantial loss of the character above described, then the amount of such loss shall be deducted from the net income for the taxable year 1918 and the taxes imposed for such year by Title 2 and 3 of the Revenue Act of 1918 shall be redetermined accordingly. (See Section 234 (a) (14) and Article 261.)

## GENERAL INSTRUCTIONS

1. For complete instructions concerning the filling in of the schedules in this return, read the explanatory notes at the head thereof, and Part II of Regulations 45, relating to the income tax and war-profits and excess-profits tax on corporations. Copies of the regulations can be obtained from any collector of internal revenue or any bank.

## RETURNS.

## LIABILITY FOR FILING.

2. **Corporations generally.**—Every corporation, joint-stock company, association, and insurance company not specifically exempted by Section 231 of the revenue act of 1918, and having a net income for the taxable year of \$3,000 or more, is subject to the war-profits and excess-profits tax and must file a complete return on this form.

3. A corporation, joint-stock company, association, or insurance company (not exempted by Section 231) having a net income less than \$3,000 must also file a return on this form, filling that part of Schedule IV under the headings "Income tax" and (if necessary) "Adjustment of tax for fiscal year ended in 1918," and all the schedules called for on pages 2 and 3; and answering all questions on page 6.

4. **Foreign corporations.**—Foreign corporations subject to the law are required to make returns to the collector in whose district is located its principal office or agency through which is transacted the business in the United States. The gross income to be returned includes only the gross income from sources within the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and all amounts received representing profits on the manufacture and disposition of goods within the United States. (See Articles 91, 92, 548, and 625 of Regulations 45.)

5. A foreign corporation should fill in and submit all the schedules called for on pages 2 and 3 of the return with respect to its income from sources within the United States, and should compute its income tax (Schedule IV), claiming, however, no specific exemption (Item 15). It should enter 50 per cent of its net income as its war-profits and excess-profits tax, pending determination by the Commissioner of the amount of tax assessable (see Instructions, page 1, paragraph 10).

6. **Partnerships, and personal service corporations.**—Partnerships and personal service corporations must make a return on Form 1065. (See Article 624 of Regulations 45.)

## CONSOLIDATED RETURNS.

7. **Affiliated corporations,** as defined in Section 240 of the Act and Articles 632 and 633 of the Regulations, must file a consolidated return. As provided in Article 632, the parent or principal reporting company must file the consolidated return on this form with the collector of the district in which its principal office is located. All supplementary and supporting schedules should be prepared in columnar form, one column being provided for each corporation included in the consolidation, so that the composition of consolidated net income and consolidated invested capital may be readily examined.

8. **Subsidiary corporations and other affiliated corporations** whose net income and invested capital are included in the return of a parent corporation or a principal reporting corporation must fill in and file Form 1122 with the collector in whose district their principal office is located.

## PERIOD COVERED.

9. The taxable year is the calendar year 1918 or (if the corporation makes its return for a fiscal period of 12 months ending on the last day of some month other than December) the fiscal period ended in the calendar year 1918.

10. A corporation desiring to change the period for which its return is made from a calendar year to a fiscal year or vice versa, or from one fiscal year to another, must give written notice to the collector of such change and the reasons therefor at least 30 days before the due date of its return on the basis of its existing taxable year and at least 30 days before the due date of the return on the basis of the proposed taxable year. (See Articles 26 and 431 of Regulations 45 and Section 226 of the revenue act of 1918.)

11. A new form will be issued for corporations filing returns for fiscal years ending in 1919.

## TIME AND PLACE FOR FILING.

12. Returns for the calendar year 1918 and for fiscal years ended in 1918 must be sent to the collector of internal revenue for the district in which the corporation's principal place of business is located so as to reach the collector's office on or before March 15, 1919, unless an extension of time has been granted.

13. If it is not possible to file a completed return on this form or on Form 1122, as the case may be, on or before March 15, 1919, an extension of time may be obtained by filing, on or before March 15, 1919, a tentative return and estimate of taxes assessable, in duplicate, on Form 1031 T, and remitting with such return at least one-fourth of the estimated taxes shown thereon.

14. In case of neglect to file either a completed return or a tentative return within the prescribed time the collector is authorized to grant an extension of not more than 30 days, provided such neglect was due to absence or sickness, and provided an application for such extension is made in writing prior to the expiration of the period for which an extension may be granted. In meritorious cases the Commissioner is authorized to grant a further extension; but no such further extension will be granted (except on account of absence or sickness), unless a tentative return has been filed on Form 1031 T and at least one-fourth of the estimated tax has been paid. (See Articles 442 to 444 of Regulations 45.)

## SIGNATURES AND VERIFICATION.

15. Returns must be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer of the corporation. The return of a foreign corporation having an agent in the United States shall be sworn to by such agent. If receivers, trustees in bankruptcy, or assignees are operating the property or business of the corporation, such receivers, trustees, or assignees shall execute the returns for such corporations, under oath.

## PAYMENT OF TAXES.

16. The tax should be paid by sending or bringing with the return a check or money order drawn to the order of "Collector of Internal Revenue at [insert name of city and State]."

17. Do not send cash through the mail or pay it in person except at the office of the collector or a regularly established internal-revenue stamp office.

18. At least one-fourth of the tax is due at the same time that the return is due.

19. An additional amount sufficient to bring the total payments up to one-half of the tax must be paid on or before June 15, 1919.

20. An additional amount sufficient to bring the total payments up to three-fourths of the tax must be paid on or before September 15, 1919.

21. The entire remainder of the tax must be paid on or before December 15, 1919.

22. If any payment is not made when due, the entire unpaid balance of the tax will become due 10 days after demand therefor by the collector.

23. If you pay in cash, do not fail to get a receipt at the time of payment. If you pay by check or money order, your canceled check or your money-order receipt will serve as a receipt.

## PENALTIES.

## UNDERSTATEMENT OF TAXES DUE, TO NEGLIGENCE OR FRAUD.

24. If taxes are understated through negligence on the part of the taxpayer and without attempt to defraud, there shall be added as part of the tax 5 per cent of the total amount of the deficiency plus interest at the rate of 12 per cent per annum on the amount of the deficiency of each installment from the time the installment was due. If an understatement is false or fraudulent with intent to evade the tax, there shall be added as part of the tax 50 per cent of the amount of the deficiency.

## FOR FAILING TO PAY TAX WHEN DUE.

25. If any tax remains unpaid after the date when it is due and for 10 days after notice and demand by the collector there shall be added as part of the tax the sum of 5 per cent of the amount due but unpaid, plus interest at the rate of 12 per cent per annum on such amount from the time it became due.

## FOR FAILING TO MAKE RETURN ON TIME.

26. A penalty of not more than \$1,000 attaches for failure to file a return or to pay the tax within the time required by law. If the failure is willful or an attempt is made to defeat or evade the tax, the penalty is \$10,000 or imprisonment for not more than one year, or both, together with cost of prosecution.



# COMPUTATION OF WAR AND EXCESS PROFITS TAX FOR FISCAL YEAR

CORPORATION MAKING RETURN FOR FISCAL YEAR ENDING MARCH 31, 1918

Reg. 45, Art. 955

PAGES		FORM 1120 SCHEDULE & ITEM
772-775	Two computations are made, one under 1917 law, and one under 1918 law, and proportionate part of tax so computed is shown.	II-10 I-6
765-766	Average Pre-War Invested Capital.....	\$ 50,000.00
699, 812-813	Average Pre-War Net Income.....	3,500.00
	As computed under 1917 law:	
	Taxable year Invested Capital.....	100,000.00
699, 761-762	Taxable year Net Income.....	75,000.00
699, 717-757	As computed under 1918 law:	
	Taxable year Invested Capital.....	125,000.00
190, 391-392	Taxable year Net Income.....	70,000.00

Such a difference in these amounts as computed under the two laws may readily occur where, for example, a corporation is allowed under the 1918 law a deduction for interest, amortization, etc., which it was not allowed under the 1917 law, or where, under the 1918 law, it is allowed a greater amount of invested capital on account of intangible property paid in for stock or shares than allowed under the 1917 law.

## 1917 COMPUTATION

802-803	Ratio of Pre-War Net Income (\$3,500) to Pre-War Invested Capital (\$50,000) = 7%	
	7% of 1917 Invested Capital (\$100,000).....	\$ 7,000.00
	Specific .....	3,000.00
		<u>\$10,000.00</u>

# 1917 COMPUTATION

704

	DEDUCTION	AMOUNT TAXABLE	TAX
15% of Invested Capital...	\$10,000.00	\$ 5,000 at 20%	\$ 1,000.00
15% to 20% "	.....	5,000 at 25%	1,250.00
20% to 25% "	.....	5,000 at 35%	1,750.00
25% to 33% "	.....	8,000 at 45%	3,600.00
Above 33% "	.....	42,000 at 60%	25,200.00
Total Net Income.....	<u>\$75,000.00</u>	Total Tax.....	<u>\$32,800.00</u>

Number of days of fiscal year 1917-1918 falling in 1917 is 275.

609 Tax for 1917 portion of fiscal year is, therefore, 275/365 of \$32,800 = \$24,712.33 IV - 22

704 - 705

# 1918 COMPUTATION

714

	SCHEDULE & ITEM	PAGES	WAR PROFITS CREDIT	SCHEDULE & ITEM
EXCESS PROFITS CREDIT				
8% of 1918 Invested Capital...	III - 1	714 - 715	Specific .....\$ 3,000.00	III - 7
Specific .....	III - 2		Pre-War Net Income. 3,500.00	III - 4
			10% of Increased In- vested Capital (\$125,- 000-\$50,000).....	III - 5
	III - 3		<u>\$13,000.00</u>	III - 8
		714	But 10% of 1918 In- vested Capital (\$125,- 000) is allowed.....	III - 6
			Plus Specific.....	III - 7
			Thus the War Profits Credit is.....	III - 8
			<u>\$15,500.00</u>	

		FORM 1120	
		SCHEDULE & ITEM	
		IV - 1 - Col. 2	TAX
		IV - 1 - Col. 3	
		IV - 1 - Cols. 4, 5, 6	
20% of 1918 Invested Capital.....			\$25,000.00
Less: Excess Profits Credit.....			13,000.00
At 30%.....			<u>\$12,000.00</u>
1918 Net Income in excess of 20% of Invested Capital (\$70,000— \$25,000) at 65%.....			<u>\$45,000.00</u>
1918 Net Income .....			<u>\$70,000.00</u>
Less: War Profits Credit.....			15,500.00
At 80% .....			<u>\$54,500.00</u>
Tax computed under 1st and 2d brackets.....			<u>\$43,600.00</u>
Tax under 3d bracket.....			32,850.00
Total Tax .....			<u>10,750.00</u>
Number of days of fiscal year 1917-1918 falling in 1918 is 90.			<u>\$43,600.00</u>
Tax for 1918 portion of fiscal year is, therefore, 90/365 of \$43,600 =			<u>\$10,750.68</u>
Tax for portion of fiscal year falling in 1917, as above.....			24,712.33
'Total Excess and War Profits Tax Payable.....			<u>\$35,463.01<sup>1</sup></u>

<sup>1</sup>Tax already paid for fiscal year ending in 1918 is deducted (IV - 24) from IV - 23.

COMPUTATION OF FEDERAL INCOME, WAR PROFITS AND WAR EXCESS PROFITS TAXES PAYABLE BY A CORPORATION REPORTING UPON A FISCAL YEAR BASIS ENDING SEPTEMBER 30, 1918

ASSETS	SEPTEMBER 30,	SEPTEMBER 30,	LIABILITIES	SEPTEMBER 30,	SEPTEMBER 30,
	1918	1917		1918	1917
Cash .....	\$ 50,000.00	\$ 5,500.00	Notes Payable .....	\$ 1,000.00	\$ 80,000.00
U. S. Government Obligations.	75,000.00	5,000.00	Accounts Payable .....	225,000.00	120,000.00
Notes Receivable.....	42,000.00	12,000.00	Accrued Accounts .....	3,000.00	1,500.00
Accounts Receivable .....	150,000.00	100,000.00			
Inventory .....	450,000.00	175,000.00		\$229,000.00	\$201,500.00
Equipment and Fixtures .....	8,500.00	6,500.00	CAPITAL		
Investments (Corporate stocks)	15,000.00	15,000.00	Capital Stock (net of \$5,000 held in the Treasury and acquired prior to March 3, 1917) .....	45,000.00	45,000.00
Good-will .....	25,000.00	25,000.00	Surplus .....	541,500.00	97,500.00
	\$815,500.00	\$344,000.00		\$815,500.00	\$344,000.00

INVESTED CAPITAL UNDER THE PROVISIONS OF THE 1917 LAW	
PAGE	
727-757	Capital Stock, net of treasury stock.....
	<i>Add:</i>
729	Surplus, September 30, 1917.....
734	Reserves, September 30, 1917, not deductible from gross income.....
813	Interest disallowed, \$3,000 capitalized at 6%.....
	<u>\$45,000.00</u>
	<u>\$194,500.00</u>
814-817	<i>Deduct:</i>
	Good-will proportion disallowed.....
	(Allowable only to the extent of 20% of capital stock, including treasury stock, at March 3, 1917, or \$10,000)
819	Dividend paid October 15, 1917, \$10,000. (Paid out of current year's earnings, which were proportionately \$12,500 at the time of payment)
736-737	Income and Excess Profits Taxes paid June 25, 1918, \$15,000. Effective average for year ( $\$15,000 \times 3 \frac{5}{30} \div 12$ ).....
	<u>3,958.33</u>
816	Inadmissible Assets, Corporate Stocks, \$15,000 (Offset by general indebtedness)
	Total Invested Capital (1917 Law).....
	<u>\$15,000.00</u>
	<u>18,958.33</u>
	<u>\$175,541.67</u>

INVESTED CAPITAL UNDER THE PROVISIONS OF THE 1918 LAW		SCHEDULE & ITEMS	
727	Capital Stock.....	E - 4	\$50,000.00
757	Net of Treasury Stock.....	E - 9	5,000.00
			<u>\$45,000.00</u>
729	<i>Add:</i>		
734	Surplus, September 30, 1917.....	97,500.00 E - 6	
	Reserves, September 30, 1917, not deductible from gross income.....	2,000.00 E - 7	
	Interest fully allowed (no limitation).....	.....	
		<u>\$144,500.00 E - 10</u>	

721-754	<i>Deduct:</i> Goodwill proportion disallowed..... (Allowable only to the extent of 25% of capital stock outstanding on March 3, 1917, or \$11,250) Dividend paid October 15, 1917, \$10,000 (Owing to 60- day limitation payment applies to the earnings of prior years.) Effective average for year (\$10,000 x 11 16/31 ÷ 12)..... Income and Excess Profits Taxes, paid June 25, 1918, \$15,000. Effective average for year, (\$15,000 x 3 5/30 ÷ 12).....	\$13,750.00	G - I
733		9,596.77	H - I
736-737		3,958.33	H - 2
		27,305.10	
722-723	Inadmissible Assets (Corporate Stocks).....	\$15,000.00	L - (c), (d) & (e)
	Total Assets, September 30, 1917.....	\$117,194.90 (A)	
734	Add: Non-deductible reserves.....	\$344,000.00	
		2,000.00	
		\$346,000.00	
		13,750.00	
721-754	<i>Deduct:</i> Proportion of goodwill disallowed.....	\$332,250.00	L - (c) & (f)
734	Aggregate Admissible and Inadmissible Assets, September 30, 1917.....		
	Total Assets, September 30, 1918.....	\$815,500.00	
	Add: Non-deductible reserves.....	2,500.00	
721-754	<i>Deduct:</i> Proportion of goodwill disallowed.....	\$818,000.00	
		13,750.00	
	Aggregate Admissible and Inadmissible Assets, September 30, 1918 .....	804,250.00	L - (d) & (g)
		\$1,136,500.00	
	Average aggregate Admissible and Inadmissible Assets.....	\$568,250.00 (B)	L - [(e) & (h)], (i)
	Ratio of A to B.....	2.64%	L - (j)
	<i>Deduct:</i> 2.64% of invested capital (\$117,194.90).....		
	Total Invested Capital (1918 Law).....	3,093.95	II - 8
		\$114,100.95	II - 9

PAGE	COMPUTATION OF TAX	SCHEDULE & ITEMS A - 25 & I - 7
714	UNDER 1918 LAW:	
	Taxable Income.....	\$300,000.00
	Invested Capital.....	<u>\$114,100.95</u>
	Excess Profits Credit:	
	8% of Invested capital.....	\$9,128.08
	Specific exemption.....	<u>3,000.00</u>
	War Profits Credit:	
	10% (minimum) of invested capital.....	<u>\$12,128.08</u>
	Specific exemption.....	<u>\$11,410.10</u>
714		<u>3,000.00</u>
		<u>\$14,410.10</u>

BRACKET	CLASSES OF INCOME & ITEMS	SCHEDULE	INCOME	EXCESS PROFITS CREDIT	BALANCE SUBJECT TO TAX RATE	AMOUNT OF TAX
704-705	1 0.00 to 20% of invested capital....	IV - 1	\$ 22,820.19	\$12,128.08 IV - 1 - Col. 3	\$10,692.11 30% IV - 1 - Col. 4	\$ 3,207.63 IV - 1 - Col. 6
	2 In excess of 20% invested capital	IV - 2	277,179.81	..... 277,179.81 65% IV - 2 - Col. 4	180,166.88 IV - 2 - Col. 6	
	Taxable Income.....	IV - 3 & 4	\$300,000.00	\$12,128.08 \$287,871.92 IV - 3 - Col. 3 IV - 3 - Col. 4		\$183,374.51 IV - 3 - Col. 6
705-710	War Profits Credit.....	IV - 5	14,410.10			
	Less Brackets 1 and 2.....	IV - 6	\$285,589.90 at 80%	\$228,471.92 IV - 7 183,374.51 IV - 8		45,097.41 IV - 9
466	War Profits and Excess Profits Tax.....	IV - 12	\$300,000.00			\$228,471.92 IV - 10
	Credit War Profits and Excess Profits tax.....	IV - 14	228,471.92			
	Specific credit .....	IV - 15	\$71,528.08 2,000.00			
52	Income Tax on.....	IV - 16	\$69,528.08 at 12%.....			8,343.37 IV - 17
115	Total Income, War Profits and Excess Profits Taxes.....					\$236,815.29 IV - 20
117	9 months' proportion or 75% thereof.....					\$177,611.47 IV - 21



PAGES	UNDER 1917 LAW:	SCHEDULE & ITEMS
117-118	Net Income.....	\$300,000.00
454	Add: Interest disallowed.....	3,000.00
	Taxable Income.....	<u>\$303,000.00</u>
	Invested Capital.....	<u>\$175,541.67</u>
802	Deduction:	
	9% of invested capital.....	\$ 15,798.75
	Specific.....	3,000.00
	Total Deduction.....	<u>\$ 18,798.75</u>
794	CLASSES OF INCOME	BALANCE SUBJECT TO TAX RATE OF TAX
	0.00 to 15% of invested capital.....	\$ 26,331.25 \$ 18,798.75 20% \$ 1,506.50
	15% to 20% of invested capital.....	8,777.08 25% 2,194.27
	20% to 25% of invested capital.....	8,777.08 35% 3,071.98
	25% to 33% of invested capital.....	14,043.33 45% 6,319.50
	In excess of 33% of invested capital.....	245,071.26 60% 147,042.76
		<u>\$303,000.00</u> <u>\$18,798.75</u> <u>284,201.25</u> <u>\$160,135.01</u>
466	Credit Excess Profits Tax.....	160,135.01
115	Income Tax on.....	142,864.99 at 6%..... 8,571.90
115	Dividends on corporate stocks (excluded from taxable income as above) \$1,050 at 2%.....	21.00
	Total Income and Excess Profits Taxes.....	<u>\$168,727.91</u> IV - 24
117	Three months' proportion or 25% thereof.....	<u>\$ 42,181.98</u> IV - 22
117-118	UNDER 1917 LAW AND 1918 LAW COMBINED:	
	3 months' tax under the 1917 law.....	\$ 42,181.98 IV - 22
	9 months' tax under the 1918 law.....	177,611.47 IV - 21
	Total Income, War Profits and Excess Profits Taxes for fiscal year ended September 30, 1918.....	<u>\$219,793.45</u> IV - 23



PAGES  
700 - 708

1919 COMPUTATION  
Reg. No. 45, Art. 955

714	EXCESS PROFITS CREDIT	PAGE	FIRST BRACKET
	As above.....	707	20% of 1919 Invested Capital.... \$25,000.00
			Less: Excess Profits Credit.... 13,000.00
708	No War Profits tax for 1919		At 20%..... \$12,000.00
			<u>\$ 2,400.00</u>
			SECOND BRACKET
			1919 Net Income in excess of
			20% of Invested Capital
			(\$60,000-\$25,000) at 40%.. \$35,000.00
			<u>14,000.00</u>
			<u>\$16,400.00</u>
700	Number of days of fiscal year 1918-1919 falling in 1919 is 90.		
	Tax for 1919 portion of fiscal year is, therefore, 90/365 of \$16,400 =		
	Tax for portion of fiscal year falling in 1918, as above.....		\$ 4,043.84
			<u>26,821.92</u>
	Total Excess and War Profits Tax payable.....		<u>\$30,865.76</u>



PAGES	FORM 1120 SCHEDULE & ITEM
702-708	IV - 1 - Col. 2 IV - 1 - Col. 3
	20% of Invested Capital (\$90,410.96)..... \$18,082.19
	Excess Profits Credit..... 9,482.88
	At 30% ..... \$ 8,599.31
	SECOND BRACKET
	Net Income in excess of 20% of Invested Capital (\$50,000—\$18,082.19) at 65%..... \$31,917.81
	THIRD BRACKET
	Net Income ..... \$50,000.00
	Less: War Profits Credit..... 11,291.11
	80% of \$38,708.89..... \$38,708.89
	Tax computed under first and second brackets..... \$30,967.11
	Tax under third bracket..... 23,326.37
	Total Excess and War Profits Tax..... 7,640.74
708-710	IV - 9 IV - 10
	But under Sec. 302 (limitation upon tax) computed as follows:
	Net Income in excess of \$3,000 and not in excess of \$20,000 (\$20,000—\$3,000), \$17,000 at 30% =..... \$ 5,100.00
	Net income in excess of \$20,000 (\$50,000—\$20,000), \$30,000 at 80% =..... 24,000.00
	The Total Tax payable would be..... \$29,100.00
	IV - 11

COMPUTATION OF WAR AND EXCESS PROFITS TAX  
WHERE THERE IS NO TAX UNDER THIRD BRACKET

PAGES	Reg. 45, Art. 717	FORM 1120 SCHEDULE & ITEM
772-775	Average Pre-War Invested Capital.....	\$50,000.00 II-10
765-766	Average Pre-War Net Income.....	20,000.00 I-6
717-757	1918 Invested Capital.....	100,000.00 II-9
190, 391-392	1918 Net Income.....	40,000.00 I-7
714	<b>EXCESS PROFITS CREDIT</b>	
	<b>SCHEDULE &amp; ITEM</b>	<b>WAR PROFITS CREDIT</b>
	8% of 1918 Invested Capital.....	Specific ..... \$ 3,000.00 III-7
	Less: Excess Profits Credit.....	Pre-War Net Income.. 20,000.00 III-4
	Specific ..... \$ 8,000.00 III-1	Plus 10% of Increase
	Specific ..... 3,000.00 III-2	in Invested Capital.. 5,000.00 III-5
	<u>    \$11,000.00 III-3</u>	<u>    \$28,000.00 III-8</u>
703-708	<b>FIRST BRACKET</b>	
	20% of 1918 Invested Capital (\$100,000).....	IV-1-Cdl. 2
	Less: Excess Profits Credit.....	IV-1-Col. 3
	At 30% .....	IV-1-Cols. 4, 5, 6
	<b>SECOND BRACKET</b>	
	1918 Net Income in excess of 20% of Invested Capital, at 65%...	13,000.00 IV-2-Cols. 2, 4, 5, 6
	<b>THIRD BRACKET</b>	<u>    \$15,700.00 IV-3-Col. 6</u>
	1918 Net Income.....	IV-4
	War Profits Credit.....	IV-5
	<u>    \$12,000.00</u>	IV-6
	80% of \$12,000 = \$9,600, which is less than the tax computed under the 1st and 2d brackets, thus there is no tax under the 3d bracket.....	.....
	<b>Total Tax .....</b>	<u>    \$15,700.00 IV-10</u>

COMPUTATION OF WAR AND EXCESS PROFITS  
TAX FOR CALENDAR YEAR 1918 AND EXCESS  
PROFITS TAX FOR CALENDAR YEAR 1919

PAGES	Reg. 45, Art. 716	FORM 1120	
		SCHEDULE	ITEM
772-775		Average Pre-War Invested Capital.....	\$50,000.00
765-766		Average Pre-War Net Income.....	10,000.00
717-757		1918 Invested Capital.....	100,000.00
190, 391-392		1918 Net Income.....	40,000.00
		1919 Invested Capital.....	110,000.00
		1919 Net Income.....	50,000.00
<hr/>			
714		EXCESS PROFITS CREDIT 1918	
		8% of 1918 Invested Capital.....	\$8,000.00
		Specific .....	3,000.00
		WAR PROFITS CREDIT 1918	
		Specific .....	\$3,000.00
		Pre-War Income.....	10,000.00
		Plus 10% of Increase in Invested Capital	
		((\$100,000-\$50,000))..	5,000.00
		<hr/>	
		III - 3	\$11,000.00
		<hr/>	
		III - 7	\$18,000.00
		III - 4	
		III - 5	
		III - 8	

# COMPUTATION FOR 1918

## FIRST BRACKET

20% of 1918 Invested Capital (\$100,000).....  
 Less: Excess Profits Credit.....

IV - 1 - Col. 2  
 IV - 1 - Col. 3

TAX

\$20,000.00  
 11,000.00

At 30% .....

\$ 9,000.00

\$2,700.00  
 IV - 1 - Cols. 4, 5, 6

## SECOND BRACKET

1918 Net Income in excess of 20% of Invested Capital, at 65%...

13,000.00  
 IV - 2 - Cols. 2, 4, 5, 6

At 80% .....

\$20,000.00

\$15,700.00  
 IV - 3 - Col. 6.

## THIRD BRACKET

1918 Net Income.....  
 Less: War Profits Credit.....

IV - 4  
 IV - 5

\$40,000.00  
 18,000.00

At 80% .....

\$22,000.00

IV - 6, 7

Tax computed under 1st and 2d brackets.....

IV - 8

15,700.00

Amount of 3d bracket.....

IV - 9

1,900.00

Total Tax at 1918 rates.....

IV - 10

\$17,600.00

# COMPUTATION FOR 1919

## EXCESS PROFITS CREDIT 1919

Specific ..... \$ 3,000.00 20% of 1919 Invested  
 8% of 1919 Invested Capital..... 8,800.00 Capital (\$110,000).  
 Less: Excess Profits  
 Credit .....

## FIRST BRACKET

\$22,000.00  
 11,800.00

\$11,800.00

\$2,040.00

At 20% .....

\$10,200.00

## SECOND BRACKET

1919 Net Income in  
 excess of 20% of  
 Invested Capital at  
 40% .....

\$28,000.00

11,200.00

Total Tax at 1919  
 rates .....

\$13,240.00

703-707

714

708



# COMPUTATION OF WAR AND EXCESS PROFITS TAX WHERE NET INCOME OF CORPORATION IN 1919 IS DERIVED IN PART FROM GOVERNMENT CONTRACT

## Reg. 45, Art. 719

PAGES		
772-775	Two computations are made, one on the 1918 basis, and one on 1919 basis; then the proportions are taken as shown below.	
765-766	Average Pre-War Invested Capital.....	\$ 50,000.00
717-775	Average Pre-War Net Income.....	10,000.00
190, 391-392	1919 Invested Capital.....	110,000.00
	1919 Net Income:	
	From Government contracts.....	\$20,000.00
	From other sources.....	30,000.00
		<u>\$50,000.00</u>

## COMPUTATION ON 1918 BASIS.

	SCHEDULE & ITEM	PAGES	WAR PROFITS CREDIT
714	III-1	714-715	Specific.....\$ 3,000.00
	III-2		Pre-War Net Income.... 10,000.00
			Plus 10% of increase in Invested Capital (\$110,000 — \$50,000) ..... 6,000.00
	III-3		<u>\$11,800.00</u>
			<u>\$10,000.00</u>

## FIRST BRACKET

20% of 1919 Invested Capital (\$110,000).....	\$22,000.00	Tax
Less: Excess Profits Credit.....	11,800.00	
At 30%.....	<u>\$10,200.00</u>	\$ 3,060.00
SECOND BRACKET		
1919 Net Income in Excess of 20% of Invested Capital (\$50,000—\$22,000) at 65%..	<u>\$28,000.00</u>	18,200.00
THIRD BRACKET		
1919 Net Income.....	<u>\$50,000.00</u>	
Less: War Profits Credit.....	19,000.00	
At 80%.....	<u>\$31,000.00</u>	
Tax under 1st and 2d brackets.....	\$24,800.00	
Amount of tax under third bracket .....	<u>21,260.00</u>	
Total Tax.....	3,540.00	
Proportion of Income from Government contracts (\$20,000) to Total Income (\$50,000) = $\frac{2}{5}$		<u>\$24,800.00</u>
Tax payable on Income from Government contracts = $\frac{2}{5}$ of tax computed as above \$24,800.....		<u>\$ 9,920.00</u>

247

707

# COMPUTATION ON 1919 BASIS

EXCESS PROFITS CREDIT		
Specific .....	\$ 3,000.00	
8% of 1919 Invested Capital.....	8,800.00	
	<u>\$11,800.00</u>	
FIRST BRACKET		
20% of 1919 Invested Capital (\$110,000).....	\$22,000.00	
Less: Excess Profits Credit.....	<u>11,800.00</u>	
At 20% .....	<u>\$10,200.00</u>	Tax
		\$ 2,040.00
SECOND BRACKET		
1919 Net Income in excess of 20% of Invested Capital (\$50,000—\$22,000), \$28,000 at 40% .....	11,200.00	
Total Tax for 1919.....	<u>\$13,240.00</u>	
Proportion of Income from sources other than from Government contracts (\$30,000) to total income (\$50,000) $\frac{3}{5}$ .....	\$ 7,944.00	
Tax payable on such Income: $\frac{3}{5}$ of tax computed as above (\$13,240) =.....	<u>\$17,864.00</u>	
Total Tax payable (\$9,920 plus \$7,944) =.....		

707

708

# LIMITATION OF TAX (WAR AND EXCESS PROFITS)

Reg. 45, Art. 731-732

PAGES  
708-710

FORM 1120  
SCHEDULE & ITEM

Under Sec. 302 the limitation placed upon the Excess and War Profits Tax is computed as follows:

Net Income .....	\$50,000.00
Net Income in excess of \$3,000 and not in excess of \$20,000	
Net Income in excess of \$3,000 = \$17,000 at 30% .....	\$ 5,100.00
Net Income in excess of \$20,000 (\$50,000 — \$20,000) = \$30,000, at 80% = .....	24,000.00
	<hr/>
	\$29,100.00
	<hr/>
	<hr/>

IV - 11

If the tax computed under Sec. 301 exceeds the tax computed under Sec. 302, then the lower amount is the tax to be paid.

ILLUSTRATION OF CORPORATION REPORTING FOR PERIOD LESS THAN 12 MONTHS (JULY 1 TO DECEMBER 31) AND TAKING BENEFIT OF LIMITATION OF TAX UNDER SECTION 302

	1918 Invested Capital.....	\$120,000	
	1918 Net Income (6 months).....	30,000	
	EXCESS PROFITS CREDIT		The Invested Capital and Excess Profits Credit are reduced in proportion of number of months in period to 12 months, viz., $\frac{1}{2}$
714	Specific .....	\$ 3,000	(a) $\frac{1}{2}$ of Invested Capital = \$60,000
	8% of Invested Capital.....	9,600	(b) $\frac{1}{2}$ of Excess Profits Credit = 6,300
		<u>\$12,600</u>	
	FIRST BRACKET		
707	20% of (a).....	\$12,000	
	Less: Excess Profits Credit (b) ..	6,300	
		<u>\$ 5,700 at 30% = \$ 1,710</u>	
	SECOND BRACKET		
707	Net Income in excess of 20% of Invested Capital (a) = .....	\$18,000 at 65% = 11,700	
		<u>\$13,410</u>	Total Excess Profits Tax

714-715	WAR PROFITS CREDIT	The War Profits Tax would be:
	Specific .....	Net Income .....
	10% of Invested Capital.....	Less: War Profits Credit..
		<u>\$22,500 at 80% = \$18,000</u>
	Reduced to $\frac{1}{2}$ =	
		<u>\$15,000</u>
		<u>\$ 7,500</u>

709 But Section 302 provides that the tax shall not exceed 30% of the Net Income in excess of \$3,000 and not in excess of \$20,000, viz.:  
 \$20,000 — \$3,000 = \$17,000 at 30% = ..... \$ 5,100  
 And 80% of the Net Income in excess of \$20,000, viz., \$10,000 = ..... 8,000  
\$13,100

Therefore the Excess and War Profits Tax to be paid is \$13,100.  
 The Treasury has ruled that the full limitation under Section 302 will be allowed even when return is made for part of a year, as shown above.

Page 708

**Limitation of tax.**—The illustration on page 1215 appears in Reg. No. 45, Articles 731 and 732.

As stated on page 701, the policy of the Department is to apportion exemptions, deductions, etc. There is nothing in the foregoing illustrations to indicate that the limitation in the amount of tax as provided in Section 302 is correspondingly reduced when returns are made for part of the year, but it had been thought that such reduction would be required because otherwise a corporation which makes a return for part of a year would secure an advantage through the operation of Section 302 to which it was believed the corporation was not entitled, if its earnings continued at the same rate for an entire year. However, the Treasury has decided to allow the full relief even though the return is for only part of a year.

Page 709

The amount of tax under the second bracket should be \$45,500.

COMPUTATION OF FEDERAL INCOME, WAR PROFITS AND EXCESS PROFITS TAXES PAYABLE BY A CORPORATION PART OF WHOSE INCOME IS DERIVED FROM THE MANUFACTURE AND SALE OF MACHINE TOOLS AND EQUIPMENT AND PART FROM SERVICES RENDERED IN CONNECTION WITH THE SCIENTIFIC LAYOUT OF MANUFACTURING PLANTS

COMPARATIVE BALANCE SHEET

ASSETS

	DEC. 31, 1918	DEC. 31, 1917
Cash .....	\$ 129,000.00	\$ 310,000.00
Notes Receivable—Manufactured Product .....	10,000.00	14,000.00
Accounts Receivable (Net of reserve \$3,000):		
For Manufactured Product	270,000.00	295,000.00
For Service Fees and expenses .....	10,000.00	15,000.00
For Capital Stock Subscriptions (not interest-bearing) .....	5,000.00	5,000.00
Inventory .....	1,217,000.00	1,020,500.00
Deferred Charges .....	6,500.00	6,100.00
Investments:		
U. S. Government Obligations .....	118,100.00	48,000.00
Life Insurance .....	4,975.00	3,475.00
Industrial Stocks .....	1,525.00	1,525.00
Municipal Bonds .....	3,000.00	2,000.00
Property (Net of depreciation):		
Real Estate (including appreciation \$20,000).....	54,000.00	54,000.00
Buildings .....	178,000.00	147,000.00
Machinery and Equipment.	123,000.00	105,000.00
Goodwill .....	400,000.00	400,000.00
	<u>\$2,530,100.00</u>	<u>\$2,426,600.00</u>

LIABILITIES

	DEC. 31, 1918	DEC. 31, 1917
Notes Payable .....	\$ 250,000.00	\$ 500,000.00
Accounts Payable .....	238,000.00	190,000.00
Accrued:		
Pay-roll—Factory .....	15,000.00	.....
Pay-roll—Layout Department .....	2,500.00	.....
Mortgage Bonds .....	150,000.00	200,000.00
	<u>\$655,500.00</u>	<u>\$ 890,000.00</u>
CAPITAL AND SURPLUS		
Capital Stock (authorized) (Net of treasury stock \$50,000 and unissued stock \$200,000) .....	1,250,000.00	1,250,000.00
Surplus .....	524,600.00	286,600.00
	<u>\$2,530,100.00</u>	<u>\$2,426,600.00</u>



PAGES	INVESTED CAPITAL:	SCHEDULE & ITEM
717	Capital stock.....	E-4
727	Deduct: Treasury and unissued stock.....	E-9
		\$1,500,000.00
		250,000.00
		<u>\$1,250,000.00</u>
	Surplus, December 31, 1917.....	E-6
	Bad debts reserve.....	E-7
		289,600.00
		<u>\$1,539,600.00</u>
727	Adjustments (deduct):	E-10
745-746	Capital stock subscriptions (not interest-bearing).....	G-7
730	Appreciation of real estate.....	G-5
720-721, 754	Goodwill in excess of 25% of outstanding stock, net of treasury stock, on March 3, 1917 (\$1,250,000).....	G-1
733-734	Dividend paid March 15, 1918.....	
	Proportionate earnings, January 1 to March 15, 1918.....	H-1 - Col. 5
		87,500.00
		<u>\$125,000.00</u>
		122,951.61
	Applicable to earnings of prior years.....	
		<u>\$ 2,048.39</u>
	Effective average for year (\$2,048.39 x 9 16/31 ÷ 12).....	
736-737	Income and Excess Profits Tax paid June 25, 1918.....	H-1 - Col. 7
		1,624.40
		<u>\$119,000.00</u>
	Effective value for year \$119,000 x 6 5/30 ÷ 12	
		61,152.78
		<u>175,277.18</u>
		<u>\$1,364,322.82</u>
722-723	INADMISSIBLE ASSETS:	
	Industrial stocks, December 31, 1917.....	H-Col. 5
	Municipal bonds, December 31, 1917.....	L (c)
		\$ 1,525.00
		2,000.00
		<u>\$ 3,525.00</u>
	Industrial stocks, December 31, 1918.....	
	Municipal bonds, December 31, 1918.....	L (d)
		\$ 1,525.00
		3,000.00
		<u>4,525.00</u>
		<u>\$ 8,050.00</u>
	Average Inadmissible Assets.....	L (e)
		<u>\$ 4,025.00 (A)</u>

735	Total assets, December 31, 1917.....	\$2,426,600.00	
	Add: Non-allowable reserve for bad debts.....	3,000.00	
		<u>\$2,429,600.00</u>	
739	Deduct:		
754	Capital stock subscriptions.....	\$ 5,000.00	
	Appreciation .....	20,000.00	
	Disallowed goodwill.....	87,500.00	
		<u>112,500.00</u>	
	Aggregate Admissible and Inadmissible Assets, December 31, 1917.....		L (c) & (f)
		<u>\$2,317,100.00</u>	
735	Total assets, December 31, 1918.....	\$2,530,100.00	
	Add: Non-allowable reserve for bad debts.....	3,000.00	
		<u>\$2,533,100.00</u>	
739	Deduct:		
754	Capital stock subscriptions.....	\$ 5,000.00	
	Appreciation .....	20,000.00	
	Disallowed goodwill.....	87,500.00	
		<u>112,500.00</u>	
	Aggregate Admissible and Inadmissible Assets, December 31, 1918.....		L (d) & (g)
		<u>\$2,420,600.00</u>	
	Average aggregate Admissible and Inadmissible Assets.....		L [(e) & (h)], (i)
	Ratio of A to B .17%		L (j)
	Deduct: .17% of Invested Capital (\$1,364,322.82)		L [(e) & (h)] - 8
		<u>\$2,368,850.00</u>	
		<u>2,319,351.47</u>	
711	Deduct: Amount of Invested Capital assigned to personal service activities.....	\$1,362,003.47	II - 9
		<u>100,000.00</u>	
		<u>\$1,262,003.47</u>	

If this item were interest-bearing it would become an admissible asset.

COMPUTATION OF TAX

Net Income from all sources, as per books.....  
Add: Non-allowable deductions (donations, life insurance premiums, etc.) net of exempt bond interest and dividends on industrial stocks.....

\$582,000.00

12,000.00

Income subject to Profits Tax:

From manufactured product..... \$366,000.00  
From personal services..... 198,000.00

66 2/3%

33 1/3%

100 %

\$594,000.00

Total .....

The specific exemption (\$3,000) is reduced to the proportion that the Net Income from non-personal service branch bears to total income (\$396,000 to \$594,000) = 2/3 of \$3,000 = \$2,000  
Excess Profits Credit:  
8% of Invested Capital.....  
Specific .....

\$100,960.28

2,000.00

\$102,960.28

War Profits Credit:

10% (minimum) of Invested Capital.....  
Specific .....

\$126,200.35

2,000.00

\$128,200.35

EXCESS PROFITS CREDIT

BALANCE SUBJECT TO TAX

AMOUNT OF TAX

RATE

BRACKET I 0.00 to 20% of Invested Capital...

2 Net Income in excess of 20% of Invested Capital (\$396,000 - \$252,400.69) .....

\$252,400.69

\$102,960.28

30%

\$ 44,832.12

IV-1-Cols. 2, 3, 4, 5, 6

143,599.31

143,599.31

65%

93,339.55

IV-2-Cols. 2, 4, 5, 6

IV - 4 \$396,000.00

\$293,039.72

138,171.67

IV - 3-Cols. 2, 3, 4, 6

Less: War Profits					
Credit .....	IV - 5	128,200.35			
	IV - 6	\$267,799.65	at 80% =	\$214,239.72	IV - 7
Less: Tax computed under 1st and 2nd brackets .....				138,171.67	IV - 8
Tax under 3rd bracket.....					IV - 9
					76,068.05
Total profits tax on non-personal service branch.....					
*Ratio of Profits Tax on income from non-personal service branch to such income (\$214,239.72 to \$396,000) = 54.10%					IV - 10
*Profits tax on income from personal service branch.....			\$198,000 at 54.10% =	107,118.00	IV - 11
Profits Tax on entire income...					
Income subject to Profits Tax.....				\$321,357.72	IV - 12
Credits: Profits Tax, as above.....				\$594,000.00	IV - 14
Interest on Liberty Bonds in excess of exemption .....				334.12	IV - 13
Specific .....				2,000.00	IV - 15
				323,691.84	
Normal Tax.....			IV - 16	\$270,308.16 at 12%	IV - 17
					32,436.98
Total Income, Excess and War Profits Taxes.....					IV - 20
					\$353,794.70

<sup>1</sup>The minimum ratio under Section 303 is 20 per cent, unless the profits tax upon the entire net income, if computed without benefit of this section, would constitute less than 20 per cent of such entire net income, in which case the profits tax shall be computed without reference to this section.

<sup>2</sup>Enter on line 11—Schedule IV, Form 1120.

COMPUTATION OF WAR AND EXCESS PROFITS TAX ON INCOME FROM BUSINESS WITH INVESTED CAPITAL AND FROM PERSONAL SERVICES; AT LEAST 30% OF ENTIRE INCOME BEING FROM PERSONAL SERVICES

Reg. 45, Arts. 741-743

PAGES		FORM 1120 SCHEDULE & ITEM	
		\$ 38,000.00 12,000.00	\$12,000.00 40,000.00 \$52,000.00
679, 710-711 772-775	Average Pre-War Invested Capital: In contracting work..... In engineering.....		
	Total .....	\$50,000.00	
765-766	Average Pre-War Net Income: From contracting..... From engineering.....	\$12,000.00 40,000.00	I-6
	Total .....	\$52,000.00	



	FORM 1120 SCHEDULE & ITEM	
	TAX	
FIRST BRACKET		
20% of 1918 Invested Capital (in contracting \$81,000).....	\$16,200.00	
Less: Excess Profits Credit.....	7,480.00	
At 30%.....	<u>\$ 8,720.00</u>	IV - 1 - Col. 2 IV - 1 - Col. 3
SECOND BRACKET		
1918 Net Income (from contracting) in excess of 20% of 1918 Invested Capital (in contracting) (\$30,000—\$16,200) at 65%	<u>\$13,800.00</u>	IV - 1 - Cols. 4, 5, 6
THIRD BRACKET		
1918 Net Income (from contracting).....	\$30,000.00	IV - 2 - Cols. 2, 4, 5, 6
Less: War Profits Credit.....	17,300.00	IV - 3 - Col. 6.
At 80%.....	<u>\$12,700.00</u>	IV - 4 IV - 5 IV - 6
No tax under 3d bracket, since the 3d bracket is less than the amount computed under 1st and 2d brackets .....	<u>\$10,160.00</u>	IV - 7
Total Tax on Income from contracting.....	<u>\$11,586.00</u>	IV - 10
Ratio of Profits Tax on Income from non-personal service branch (contracting) .....	\$11,586	
To Income from non-personal service branch .....	<u>\$30,000</u>	
The Profits tax upon Income from personal service branch (\$60,- 000) is the same percentage thereof as the tax upon the non- personal service branch is of such income, viz., 38.62%		
38.62% of \$60,000 = .....		
Tax on non-personal service branch, as above.....		
Total Excess and War Profits Tax.....	<u>\$23,172.00</u>	IV - 11
	<u>11,586.00</u>	IV - 10
	<u>\$34,758.00</u>	

**Part personal service corporation.—**

**COMPUTATION OF TAX.**—The limitation on the tax which is assessable against a corporation, part of whose income is from personal services is controlled by the following regulations:

**ALLOCATION OF NET INCOME TO PARTICULAR SOURCE.—**

**REGULATIONS.** Whenever it is necessary to determine the portion of the net income derived from or attributable to a particular source, the corporation shall allocate to the gross income derived from such source, and to the gross income derived from each other source, the expenses, losses and other deductions properly appertaining thereto, and shall apply any general expenses, losses and deductions (which cannot properly be otherwise apportioned) ratably to the gross income from all sources. The gross income derived from a particular source, less the deductions properly appertaining thereto and less its proportion of any general deductions, shall be the net income derived from such source. The corporation shall submit with its return a statement fully explaining the manner in which such expenses, losses and deductions were allocated or distributed. (Reg. No. 45, Article 715.)

**APPORTIONMENT OF INVESTED CAPITAL AND NET INCOME.—**

For the purpose of determining whether or not a corporation partly partaking of the nature of a personal service corporation is within the scope of Section 303 of the statute and also for the purpose of establishing the basis for the computation of the tax, the corporation shall apportion or allocate its invested capital between each trade or business or branch thereof as nearly as may be in accordance with the actual facts, and shall submit with its return an explanatory statement setting forth the manner in which the apportionment of the invested capital employed in the production of each part of its net income has been determined. There must be assigned to any personal service trade or business or branch thereof an amount of invested capital at least as great as that which would ordinarily be employed by a personal service corporation of similar size and standing for the payment of salaries and office expenses, maintenance of library and equipment, credit advances to clients, etc. (Reg. No. 45, Article 741.)

**COMPUTATION OF TAX UPON NET INCOME.—**

(1) The tax upon the non-personal service part of the net income is computed upon the basis of (a) such part of the entire aver-



age net income for the pre-war period as was derived from the same trade or business or branch thereof; (b) such part of the entire average invested capital for the pre-war period as was employed in the production of the part of the net income for that period determined under (a); (c) such part of the entire invested capital for the taxable year as has been employed in the production of the net income upon which the tax is being computed; and (d) the same proportion of the specific exemption and credits as the proportion which the part of the net income upon which the tax is being computed is of the entire net income. If the corporation was in existence during the prewar period, but did not conduct this trade or business or branch thereof during that period, the war profits credit shall be computed as provided in Section 311 (b) of the statute.

(2) The tax upon the personal service part of the net income is the same percentage thereof as the tax computed under (1) is of the non-personal service part of the net income. The tax under this paragraph shall in no case be less than 20 per cent of the personal service part of the entire net income, unless the tax upon the entire net income if computed in the ordinary way would be less than 20 per cent of such entire net income. In that event, and in any case in which the amount of the total tax as computed under this article is the same as or greater than the tax as computed in the ordinary way, the tax shall be computed under Section 301 of the statute. (Reg. No. 45, Article 742.)

COMPUTATION OF WAR AND EXCESS PROFITS TAX WHERE EXCESS PROFITS CREDIT IS  
NOT EXHAUSTED UNDER FIRST BRACKET

Reg. 45, Art. 718

PAGES		SCHEDULE & ITEM
772-775	Average Pre-War Invested Capital.....	\$20,000.00 II-10
765-766	Average Pre-War Net Income.....	7,000.00 I-6
717-757	1918 Invested Capital .....	20,000.00 II-9
190, 391-392	1918 Net Income.....	7,000.00 I-7
<hr/>		
714	EXCESS PROFITS CREDIT	
	8% of 1918 Invested Capital.....	\$1,600.00 III-1
	Specific .....	3,000.00 III-2
		<hr/>
		\$4,600.00 III-3
		<hr/>
	WAR PROFITS CREDIT	
	Specific .....	\$ 3,000.00 III-7
	Pre-War Net Income..	7,000.00 III-4
		<hr/>
		\$10,000.00 III-8
		<hr/>
	Nothing to be added nor deducted since there has been no increase nor decrease of 1918 Invested Capital over Pre-War Invested Capital.	

	FIRST BRACKET	TAX	SCHEDULE & ITEM
20% of 1918 Invested Capital.....	\$ 4,000.00		IV - 1 - Col. 2
Less: Excess Profits Credit.....	4,600.00		IV - 1 - Col. 3
	<u>-\$ 600.00</u>	No tax un- der 1st bracket	
	SECOND BRACKET		
Net Income in excess of 20% of 1918 Invested Capital .....	\$ 3,000.00		IV - 2 - Col. 2
Less: Amount of Excess Profits Credit not exhausted under first bracket .....	600.00		IV - 2 - Col. 3
At 65% .....	<u>\$ 2,400.00</u>	\$1,560.00	IV - 2 - Cols. 4, 5, 6
	THIRD BRACKET		
1918 Net Income .....	\$ 7,000.00		IV - 4
War Profits Credit.....	10,000.00		IV - 5
No tax under third bracket since the War Profits Credit exceeds the amount of Net Income	.....		
Total Tax .....	.....	<u>\$1,560.00</u>	
But Sec. 302 provides that the tax as computed above shall not exceed 30% of the Net Income in excess of \$3,000 and not in excess of \$20,000; in this case \$7,000-\$3,000=\$4,000 at 30%.....	.....	<u>\$1,200.00</u>	IV - 11
Thus \$1,200 is the tax to be paid.			

**Profits on sale of oil wells, etc.**—The new regulations describe the method of determining tax in the case of a sale by a discoverer.

**REGULATION.** In the case of a sale of mines, oil or gas wells, or any interest therein, as described in Article 13, the portion of the war profits and excess profits tax attributable to such a sale shall not exceed 20 per cent of the selling price. To determine the application of this provision to a particular case the corporation should compute the war profits and excess profits tax in the ordinary way upon its net income, including its net income from any such sale. The proportion of the total tax indicated by the ratio which the taxpayer's net income from the sale of the property, computed as prescribed in Article 715, bears to its total net income is the portion of the tax attributable to such sale, and if it exceeds 20 per cent of the selling price of the property such portion of the tax shall be reduced to that amount. (Reg. No. 45, Article 971.)

# COMPUTATION OF WAR AND EXCESS PROFITS TAX ON PROFITS FROM SALE OF OIL WELL

[illegible]

# THIRD BRACKET

1918 Net Income.....	\$40,000.00	IV - 4
Less: War Profits Credit.....	18,000.00	IV - 5
At 80% .....	<u>\$22,000.00</u>	IV - 6, 7
Tax computed under 1st and 2d brackets.....	\$17,600.00	
Tax under 3d bracket.....	<u>15,700.00</u>	
Total Tax .....	1,900.00	IV - 8
Gross Income for 1918 included amount derived from bona fide sale of oil well, principal value of which had been demonstrated by exploration and discovery work, viz.....	<u>\$17,600.00</u>	
Of deductions allowed, the amount applicable to this sale is.....	\$15,000.00	
Net Income attributable to sale.....	<u>800.00</u>	
Which is 35.5% of total income (\$40,000). Therefore portion of tax attributable to such sale is: 35.5% of total tax (\$17,600)	<u>\$14,200.00</u>	
But this portion of tax cannot exceed 20% of selling price (\$15,000) =		
Therefore total tax, as above.....	\$17,600.00	
Less: Tax attributable to sale.....	6,248.00	
Tax attributable to income other than from sale of oil well .....	\$11,352.00	
Plus amount to which tax on sale is limited =.....	3,000.00	
Total Excess and War Profits Tax payable.....	<u>\$14,352.00</u>	

712-713

**War profits credits.**—The new regulations specify that when an asset which was not in existence during the pre-war year is included in computing invested capital for the taxable year, or when such an asset is valued on a different basis in the two periods, the calculation of the 10 per cent of the difference must be governed by the following article:

**ADJUSTMENT FOR ASSET DIFFERENTLY VALUED IN PRE-WAR INVESTED CAPITAL.**—

**REGULATION.** In any case in which as a result of a reorganization or for any other reason any asset in existence both during the taxable year and any pre-war year is included in computing the invested capital for the taxable year, but is not included in computing the invested capital for such pre-war year, or is valued on a different basis in computing the invested capital for the two years, the difference resulting therefrom shall not be included in determining the difference 10 per cent of which is added to or deducted from the war profits credit under Section 311 (a-2). In any such case the corporation shall make the readjustment required by the statute, and shall submit with its return a full statement of the difference in such valuations and of the facts which give rise to such difference. (Reg. No. 45, Article 934.)

## CHAPTER XXXIII

### EXCESS AND WAR PROFITS TAXES

#### INVESTED CAPITAL

**Affiliated corporations.**—On pages 998 to 1004 the accounting procedure to be followed in the preparation of consolidated balance sheets and income statements had been discussed generally in connection with income tax practice. The new regulations cover the procedure which must be followed in arriving at the invested capital of affiliated corporations for the purposes of the excess profits tax.

**INTANGIBLE PROPERTY PAID IN.**—

**REGULATION.** (1) In respect of corporations whose affiliation is

in the nature of parent and subsidiary companies: (a) in the case of intangible property bona fide paid in for stock or shares prior to March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares of the consolidation outstanding on March 3, 1917 (determined as indicated in items (a) and (c) in Article 864), or in the aggregate 25 per cent of the par value of the total stock or shares shown on the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in Article 864 at the beginning of the taxable year, whichever is lowest; and (b) in the case of intangible property bona fide paid in for stock or shares on or after March 3, 1917, there may be included in invested capital an amount not exceeding the actual cash value of such property at the time paid in, or the par value of the stock or shares issued therefor, or in the aggregate 25 per cent of the par value of the total stock or shares shown by the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in Article 864 outstanding at the beginning of the taxable year, whichever is lowest. (c) When intangible property has been acquired in part before and in part after March 3, 1917, the amounts shall be ascertained, respectively, under (a) and (b) above and in the aggregate shall in no case exceed 25 per cent of the par value of the total stock or shares outstanding at the beginning of the taxable year shown in the consolidated balance sheet, being the amount of the capital stock included in items (a) and (c) in Article 864. (For Article 864 see page 998.)

(2) In respect of corporations affiliated by reason of ownership by the same interests, the limitations set forth in paragraphs (4) and (5) of subdivision (a) of Section 326 of the statute shall be applied to each corporation separately and the aggregate of the intangible property, so valued, shall be included in invested capital in the consolidated return. In respect of each of the affiliated corporations the aggregate of the amounts ascertained under the provisions of paragraphs (4) and (5) shall in no case exceed 25 per cent of the outstanding capital stock of such corporation at the beginning of the taxable year. (Reg. No. 45, Article 865.)

It should be noted that when intangible assets were acquired before March 3, 1917, the limitation of 25 per cent applies to the stock of the parent company in the hands of the public, plus the stock of affiliated corporations not owned by parent company at March 3, 1917, or the limitation applies to the par value of the total stock shown on consolidated



balance sheet at beginning of taxable years, whichever is *lower*.

If intangible assets were acquired *after* March 3, 1917, the limitation applies to the amount at the beginning of the taxable year as above stated. If acquired in part before March 3, 1917, and part after that date, the amount admissible is determined under the two calculations, respectively.

#### INADMISSIBLE ASSETS.—

REGULATIONS. Where adjustment is required in respect of inadmissible assets in accordance with the provisions of subdivision (c) of Section 326 of the statute, such adjustment shall be made on the basis of the consolidated balance sheet with due regard to the adjustments and eliminations set forth in Articles 864 and 865 and to the provisions of Articles 815-818. (Reg. No. 45, Article 866.)

#### STOCK OF SUBSIDIARY ACQUIRED FOR CASH.—

When all or substantially all of the stock of a subsidiary corporation was acquired for cash, the cash so paid shall be the basis to be used in determining the value of the property acquired. (Reg. No. 45, Article 867.)

#### STOCK OF SUBSIDIARY ACQUIRED FOR STOCK.—

When substantially all the stock of a subsidiary corporation was acquired with the stock of the parent corporation, the amount to be included in the consolidated invested capital in respect of the corporation acquired shall be the actual cash value of the stock of the subsidiary corporation at the date or dates acquired, measured by the cash value of its net assets at such date or dates (the cash value of tangible and intangible assets being separately determined), but limited to the par value of the stock of the parent corporation issued therefor, or if the stock of the parent corporation has no par value, then limited to the value of such non-par value stock ascertained in accordance with the provisions of Section 325 (b) of the statute. If in connection with such acquisition a paid-in surplus is claimed, such claim will be subject to the provisions of Article 837. (Reg. No. 45, Article 868.)

#### INVESTED CAPITAL FOR PRE-WAR PERIOD.—

The invested capital of affiliated corporations for the pre-war period shall be computed on the same basis as the invested capital for the taxable year, except that where any one or more of the corporations included in the consolidation for the taxable year were in

existence during the pre-war period, but were not then affiliated as herein defined, then the average consolidated invested capital for the pre-war period shall be the average invested capital of the affiliated corporations plus the average invested capital of the corporations not affiliated during the pre-war period. Full recognition, however, must be given to the provisions of Section 330 of the statute, particularly the last paragraph thereof, and of Articles 931-934. (Reg. No. 45, Article 869.)

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**Valuation of intangible property.**—The new regulations give the following directions for the determination of cash value of intangible property.

**INTANGIBLE PROPERTY PAID IN.**—

**REGULATION.** The actual cash value of intangible property paid in for stock or shares must be determined in the light of the facts in each case. Among the factors to be considered are (a) the earnings attributable to such intangible assets while in the hands of the predecessor owner; (b) the earnings of the corporation attributable to the intangible assets after the date of their acquisition; (c) representative sales of the stock of the corporation at or about the date of the acquisition of the intangible assets; and (d) any cash offers for the purchase of the business, including the intangible property, at or about the time of its acquisition. A corporation claiming a value for intangible property paid in for stock or shares should file with its return a full statement of the facts relating to such valuation. (Reg. No. 45, Article 851.)

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**Borrowed capital.**—The following illustrations of borrowed capital are contained in the regulations.

**SECURITIES.**—

**REGULATION.** Any interest in a corporation represented by bonds, debentures or other securities, by whatever name called, including so-called preferred stock, if with respect to the payment of either interest or principal it ranks with or prior to the interest of the general creditors, is borrowed capital and cannot be included in computing invested capital. Any such preferred stock may, however, be so included if it is deferred with respect to the payment of both interest and principal to the interest of the general creditors. (Reg. No. 45, Article 812.)

The provision that so-called preferred stock must be excluded from invested capital is limited to what in reality is a liability of a corporation. In reality the so-called preferred stock is a debt and not capital.

AMOUNTS LEFT IN BUSINESS.—

REGULATIONS. Whether a given amount paid into or left in the business of a corporation constitutes borrowed capital or paid-in surplus is largely a question of fact. Thus, indebtedness to stockholders actually cancelled and left in the business would ordinarily constitute paid-in surplus, while amounts left in the business representing salaries of officers in excess of their actual withdrawals, or deposit accounts in favor of partners in a partnership succeeded by the corporation, will be considered paid-in surplus or borrowed capital according to the facts of the particular case. The general principle is that if interest is paid or is to be paid on any such amount, or if the stockholder's or officer's right to repayment of such amount ranks with or before that of the general creditors, the amount so left with the corporation must be considered as borrowed capital and be so treated in computing invested capital. (Reg. No. 44, Article 813.)

OTHER ILLUSTRATIONS.—

Items such as deposits or amounts due to other banks shown in the balance sheet of a bank, unexpired subscriptions shown in the balance sheet of a publishing concern, etc., are deemed liabilities and cannot be included in computing invested capital. (Reg. No. 45, Article 814.)

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**Intangible property which may or may not be fully included in invested capital.**—Treasury stock should not be deducted in calculating limitation on intangible assets. Section 326 (a-4) defines the 25 per cent limitation on the inclusion of intangible assets in invested capital. The basis of the calculation is the *outstanding* capital stock at March 3, 1917, or at the beginning of the taxable year. Ordinarily treasury stock is not outstanding stock as the term "outstanding" should refer only to the public, but the fact that a corporation at some date may have some of its own stock in its possession has no bearing on the valuation of goodwill, etc. The valuation of the latter is supposed to be based upon the original issue of stock. Treasury stock frequently costs more than par. In

many cases it costs nothing. These are factors in arriving at actual invested capital (Article 862, page 1257) but are not related except very indirectly to the valuation of intangible assets. Treasury stock should not be deducted when making the 25 per cent calculation.

Page 721

**Admissible assets.**—Amplifying but not changing the comments on page 721, Article 818 mentions as admissible assets, organization expenses and deferred charges against future income.

Page 722

**Inadmissible assets.**—It was proposed that banks, bankers, *et al.*, might if they so elected include all income from inadmissible assets and thereby make all assets “admissible.” This provision, however, was stricken out before the 1918 bill became a law. The following regulation makes it plain that such a method cannot be adopted.

REGULATION. Stocks, bonds and other obligations (other than obligations of the United States), the dividends or interest from which are not required to be included in computing net income, are inadmissible assets even though no such dividends or interest have been actually paid or received during the taxable year. The failure to pay or to receive dividends or interest does not change the status of such securities as inadmissible assets. A corporation cannot by including the income from inadmissible assets as taxable income create the right to have such assets considered admissible assets. (Reg. No. 45, Article 815.)

When a corporation owns stock of another corporation the amount so invested must be deducted from invested capital, even though no dividends were received during the year. This rule is equitable, otherwise the amount invested in corporate stocks would serve to increase the excess or war profits credit applicable to the computation of the tax on income from other sources.

Page 722

**Stocks and bonds of foreign corporation.**—The stocks and bonds of a foreign corporation which has no income within

the United States are admissible assets because the net income received from such source would be taxable.

When a holding company owns the control of the stock of foreign corporations and the accounts of the foreign corporation cannot be included in consolidated statements, the investment by the holding company in stocks of the foreign corporation may be included as invested capital. This rule, of course, is subject to modification if part of the earnings of the foreign corporation are derived from sources within the United States, in which case part of the investment in the stocks of the foreign corporation would be admissible and part inadmissible.

Page 722

**When inadmissible assets are deemed to be "admissible."**

—Section 325 (a) provides that where the income derived from inadmissible assets "consists in part of gain or profit derived from the sale or other disposition thereof, or where all or part of the interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest under paragraph (2) of subdivision (a) of section 234, a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets."

The foregoing provision in effect makes admissible assets out of inadmissible assets under two conditions:

- (a) When gains have been derived from the sale of stocks or tax-exempt bonds.
- (b) When interest has been paid on money borrowed in respect of tax-exempt bonds.

It will be noted that after the calculation is made and the balance sheet items are correspondingly adjusted, in subsequent calculations wherein inadmissible assets are a factor, any part of what were previously "inadmissible" (but which under Section 325 (a) are deemed to be "admissible" assets) rank as admissible assets.

Section 326 (c) requires that invested capital be reduced by "the percentage which the amount of inadmissible assets is of the amount of admissible and inadmissible assets held during the taxable year." Any assets which under Section 325 (a) have been determined to be admissible continue to rank as admissible assets under Section 326 (c).

It will be helpful, in dealing with Sections 325 and 326, to remember that Section 325 defines all of the various classes of *assets* and *property*, whereas Section 326 defines *invested capital*.

In other words Section 325 governs the final determination of admissible and inadmissible assets, and Section 326 deals only with the items previously defined as related to invested capital.

Page 724

**When inadmissible assets are deemed to be admissible, because gains have been derived from the sale thereof.**—The reason for deducting inadmissible assets from invested capital is that income derived from the use of the capital so invested is not taxable. When gains have been realized from the sale of stocks or tax-exempt bonds it would be inequitable to impose an excess profits tax on such gains unless the capital invested therein were included as invested capital. Section 325 (a) purports to remedy the inequality by treating as admissible assets an amount of otherwise inadmissible assets equal to "a corresponding part of the capital invested in such assets."

Article 817, Reg. No. 45, contains the following illustration of the foregoing:

Municipal bonds carried on books at.....	\$100,000
Interest received therefrom.....	2,000
Profit on bonds sold for \$103,000.....	3,000

Except for the provisions of Section 325 (a), the entire \$100,000 (if there were no borrowed money) would be excluded from invested capital and the \$2,000 interest received would be excluded from taxable income, but the profit of

\$3,000 would be taxable without the benefit of any excess or war profits credit (there being no capital invested in the bonds upon which to base the credit). The illustration in the regulations applies the term "a corresponding part of the capital invested in such assets" as follows:

Interest received .....	\$2,000
Profit on sale .....	3,000
	<hr/>
Total .....	<u>\$5,000</u>

The ratio of profit to total interest and profit is  $\frac{3}{5}$  or 60 per cent, therefore it is assumed that 60 per cent of \$100,000, viz., \$60,000, is not to be deemed to be an inadmissible asset. This leaves in invested capital \$60,000 as the base upon which the excess and war profits tax is imposed. As the profit is less than the minimum credit of 8 per cent (excess profits tax) or 10 per cent (war profits tax) the profit is subject only to the income tax. As the relative profit in this case could be considerably larger before any excess profits tax would be imposed, the rule appears to be equitable.

When no income has been derived from the otherwise inadmissible asset, the entire amount invested therein is deemed to be inadmissible which is entirely equitable.

**When inadmissible assets need not be deducted from invested capital because interest paid to carry inadmissible assets is not an allowable expense (Section 325 (a)).**—The reason for deducting assets from invested capital is that the income arising from the use of the capital so invested is not taxable. When interest paid to carry the tax-exempt securities is not allowed as deductible expense, the effect is exactly the same as if an amount of non-taxable income, equal to the amount of interest paid, were taxed. Section 325 (a) purports to remedy the inequality which would result from the taxation of tax-exempt income and permits the taxpayer to treat as admissible assets an amount of otherwise "inadmissible" as-

sets, equal to "a corresponding part of the capital invested in such assets."

The section is not at all clear, and can hardly be understood, except by the use of several illustrations.

The first two illustrations indicate the justice of the rule which excludes inadmissible assets from invested capital when there is no borrowed money (and consequently no interest paid) and no gains from sales.

I. Assets (all admissible) .....	\$500,000	
Capital .....	500,000	
		<hr/>
Net income .....	\$50,000	
Excess profits credit 8 per cent.....	\$40,000	
Specific exemption .....	3,000	43,000
		<hr/>
Net income to be taxed.....		\$7,000
		<hr/>
30 per cent tax.....		\$2,100
		<hr/>
II. Assets:		
Admissible .....	\$500,000	
Municipal bonds .....	300,000	\$800,000
		<hr/>
Capital .....		800,000
		<hr/>
General income, net.....	\$50,000	taxable
Interest on bonds.....	15,000	exempt
		<hr/>
Total income per books.....	\$65,000	
		<hr/>

As there are no gains and no interest paid, the classification needs no adjustment under Section 325.

Under Section 326 (c) there must be deducted the percentage which the amount of the inadmissible assets is of the amount of admissible and inadmissible assets, viz.,  $\frac{3}{8}$  or 37½ per cent of \$800,000=\$300,000, leaving as allowable invested capital \$500,000. The exclusion of the bonds from the invested capital and the interest from the total income leaves the amount of excess profits tax the same as in illustration I, viz., \$2,100.



The next example illustrates a fairly common practice.<sup>1</sup> The corporation in illustration I buys \$300,000 of municipal bonds, borrows \$300,000 on same, receives \$15,000 interest thereon and pays \$15,000 interest on the loan.

### III. Assets:

Admissible .....	\$500,000	
Municipal bonds .....	300,000	
	<u>          </u>	\$800,000
Capital .....	\$500,000	
Note payable .....	300,000	
	<u>          </u>	800,000
		<u>          </u>
General income, net.....	\$50,000	
Interest on bonds.....	15,000	exempt
	<u>          </u>	
	\$65,000	
Interest paid .....	15,000	not deductible
	<u>          </u>	
Net income per books.....	\$50,000	
	<u>          </u>	
Taxable income .....	\$50,000	
	<u>          </u>	

Under the general provisions of the law inadmissible assets must be deducted from invested capital and borrowed money cannot be included in invested capital, and assuming that in the foregoing case the relief provided under Section 325 (a) did not apply municipal bonds (\$300,000) would be deducted from invested capital (\$500,000) which would be reduced to \$200,000, except for Section 326 (c) which provides that the deduction shall be the percentage which the inadmissible assets are of the amount of admissible and inadmissible assets.

Capital, per illustration III.....	\$500,000
The inadmissible assets are $\frac{3}{8}$ or $37\frac{1}{2}\%$ of the total assets, hence the capital is to be reduced by that percentage or	187,500
	<u>          </u>
Net invested capital .....	\$312,500
	<u>          </u>

<sup>1</sup>The margin of collateral usually required is ignored as it has no bearing on this illustration.

Taxable profit .....	\$50,000
War profits credit: <sup>1</sup>	
10 per cent .....	\$31,250
Specific exemption .....	3,000
	<hr/> 34,250
Income to be taxed.....	<hr/> \$15,750
80 per cent .....	\$12,600
Tax under illustration I.....	2,100
	<hr/>
Additional tax .....	<hr/> \$10,500

It will be seen that the effect of eliminating Section 325 is to increase the tax by \$10,500, although the taxpayer has not increased his net income at all. It would be ridiculous to impose an extra tax of \$10,500 solely on the purchase of \$300,000 municipal bonds, the gross income from which was \$15,000. It is obvious that the inhibition against the deduction of the interest paid nullifies the "tax-exempt" interest on the municipal bonds, *which alone* is the reason for deducting the investment in municipal bonds from the invested capital. If the income from the bonds is in effect taxed, the investment in the bonds, under Section 325 (a), "shall not be deemed to be inadmissible."

Taken by themselves the words "a corresponding part of the capital invested in such assets" are ambiguous, but in the light of the foregoing illustration the meaning is quite plain. The "corresponding part" must relate to the income which should be exempt from taxation but which in effect is not tax-exempt. In this case the entire interest received is in effect made taxable. Therefore under Section 325 (a) the "corresponding part of the capital invested in such assets" is \$300,000 which thus becomes an admissible asset. Therefore, there are no inadmissible assets to be deducted from the invested capital and Section 326 (c) has no bearing on the computation of the tax.

<sup>1</sup>As the war profits tax applies the excess profits computation is omitted.

The taxpayer pays the same tax as under illustration I, which is equitable because his book net income and taxable net income are the same.

It has been claimed (not by the author) that Section 325 (a) should apply only when the interest paid exceeds the interest received and then only in the ratio which the excess interest paid bears to the interest received. An illustration will show that such could not have been the intention of the law.

IV. Assets:

Admissible .....	\$500,000	
Municipal bonds .....	300,000	
	<hr/>	\$800,000
Capital .....	\$500,000	
Note payable .....	300,000	
	<hr/>	800,000
	<hr/>	<hr/>
General income, net .....	\$50,000	
Interest on bonds.....	12,000	exempt
	<hr/>	
	\$62,000	
Interest paid .....	15,000	not deductible
	<hr/>	
Net income per books.....	\$47,000	
	<hr/>	
Taxable income per books.....	\$50,000	
	<hr/>	

Section 325 (a) reads in part that when "interest derived from such assets is in effect included in the net income because of the limitation on the deduction of interest . . . a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible." The excess of interest paid above interest received is \$3,000. The ratio of \$3,000 to \$12,000 (interest received) is 25 per cent. The ratio of \$3,000 to \$15,000 (interest paid) is 20 per cent. Using the latter percentage and applying it to the capital invested in such assets, the amount which would not be deemed to be inadmissible would be:

20 per cent of (total bonds).....	\$300,000
or .....	60,000
Leaving as inadmissible .....	\$240,000
Admissible assets .....	\$500,000
Deemed to be admissible .....	60,000
	<u>560,000</u>
Total assets .....	<u>\$800,000</u>
Invested capital .....	\$500,000
Deduction under Section 326 (c) :.	
240/800 of \$500,000.....	150,000
Net invested capital.....	<u>\$350,000</u>
Taxable income .....	\$50,000
War profits credit:	
10 per cent .....	\$35,000
Specific exemption .....	3,000
	<u>38,000</u>
Income to be taxed.....	<u>\$12,000</u>
80 per cent .....	<u>\$9,600</u>
Under illustration III, book net income.....	\$50,000
War profits tax.....	12,600
Balance .....	<u>\$37,400</u>
Under illustration IV, book net income.....	\$47,000
War profits tax .....	9,600
Balance .....	<u>\$37,400</u>

It will be noted that the taxpayer is precisely in the same net position as when the interest received and interest paid were the same.

If the ratio of the excess of interest paid to interest received (25 per cent) were taken the taxpayer would be better off, net, to the extent of \$750, but there is no logical basis for considering either the 20 per cent or the 25 per cent ratio.

In either case the penalty for holding municipal bonds would be so excessive as to make it evident that there was no such intention on the part of the framers of the law.

The rule which must be deduced from Section 325 (a), as related to interest paid, is that the percentage of interest paid to interest received is the basis upon which the proportion of inadmissible assets to be deemed to be admissible, must be calculated. If the interest paid is as great or greater than the interest received, the entire amount of inadmissible assets must not be deemed to be inadmissible.

V. Assets:

Admissible .....	\$500,000	
Municipal bonds .....	300,000	
		<u>\$800,000</u>
Capital .....	\$700,000	
Note payable .....	100,000	
		<u>800,000</u>
General income, net .....	\$50,000	
Interest on bonds.....	15,000	exempt
		<u>\$65,000</u>
Interest paid .....	5,000	not deductible
		<u>\$60,000</u>
Net income per books.....	\$60,000	
		<u>\$50,000</u>
Taxable income .....	\$50,000	

In this case the ratio of interest paid to interest received is 33  $\frac{1}{3}$  per cent. In effect  $\frac{1}{3}$  of the "tax-exempt" interest is taxed by reason of the non-deductibility of the interest paid.

Bonds:

Not deemed to be admissible.....	\$300,000	
33 $\frac{1}{3}$ pct. ....	100,000	
		<u>\$200,000</u>
Deemed to be inadmissible .....		\$200,000
Admissible .....	\$500,000	
Add .....	100,000	
		<u>600,000</u>
Total assets .....		<u>\$800,000</u>

Invested Capital .....	\$700,000
Deduction under Sec. 326 (c) 2/8 of \$700,000.....	175,000
Net Invested Capital .....	<u>\$525,000</u>
Excess Profits Credit:	
8% of \$525,000 .....	\$42,000
Specific .....	<u>3,000</u>
	\$45,000
Taxable Income .....	<u>50,000</u>
Subject to tax at 30% .....	<u>\$5,000</u>
Tax payable (30% of \$5,000) .....	<u><u>\$1,500</u></u>

VI. There is some foundation in equity for the argument that when the interest paid exceeds the interest received the taxpayer is entitled to add to invested capital an amount sufficient to offset the penalty which results from the inability to deduct all interest paid. But Section 325 (a) in referring to inadmissible assets extends relief only to the extent that "a corresponding part of the capital invested in such assets shall not be deemed to be inadmissible assets." It would hardly be possible to interpret this to mean that the amount not deemed to be inadmissible should be greater than the total of the inadmissible assets, which would result in the invested capital being in excess of the total assets. Nevertheless the tax computed in this manner might be fair.

Assuming that no greater amount of inadmissible assets may be deemed not to be inadmissible than the total amount borrowed upon (even though the interest paid exceeds the interest received), it is important that when possible the collateral used be sufficient to yield an aggregate income equal to the amount of interest on the loan. Otherwise the amount of inadmissible bonds not deemed to be inadmissible will not be sufficient to offset the penalty suffered by the limitation on the interest deduction.

## Referring to illustration IV :

The excess profits tax would be.....	\$2,100
Net income as per books.....	47,000
	<hr/>
Balance .....	\$44,900
	<hr/>

That is to say, the taxpayer receives no relief whatever in respect of the interest paid in excess of the interest received.

If he were permitted to consider that the corresponding part of the assets invested in inadmissible assets related to the income which in effect was taxed when it should not be taxed, the calculation would be as follows:

Interest paid .....	\$15,000
Interest received .....	12,000
Ratio of assets not to be deemed to be inadmissible, 15/12:	
15/12 of \$300,000 = .....	\$375,000
Bonds .....	300,000
	<hr/>
To be added to invested capital.....	\$75,000
Capital .....	500,000
	<hr/>
Total invested capital.....	\$575,000
	<hr/>
Taxable income .....	\$50,000
Excess profits credit 8 per cent.....	\$46,000
Specific exemption .....	3,000
	<hr/>
	49,000
	<hr/>
To be taxed .....	\$1,000
30 per cent .....	300
	<hr/>
Net income per books.....	47,000
Excess profits tax .....	300
	<hr/>
Balance .....	\$46,700
Balance as computed on page 1149.....	44,900
	<hr/>
Difference .....	\$1,800
	<hr/>

The saving is too great. The most the taxpayer would be entitled to would be 30 per cent of the interest not deductible

(\$3,000), or \$900. The saving is greater than \$900 because the increased invested capital operates to reduce the tax imposed upon the \$50,000 of income from general sources.

The 8 per cent credit on \$75,000 = .....	\$6,000
The rate of income received on the bonds is 4 per cent of \$75,000 = .....	3,000
Excessive credit .....	<u>\$3,000</u>

on which a tax of 30 per cent should be imposed, or \$900, which in turn represents the insufficient amount of tax if calculated upon the theory that more than 100 per cent of the inadmissible assets should be restored.

When profits are derived from sale of inadmissible assets, and when interest is paid on money borrowed to carry inadmissible assets.—

## BALANCE SHEET AT END OF YEAR

## VII. Assets:

Admissible .....	\$500,000.00	
Municipal bonds beginning of year ..	\$300,000.00	
Sold December 31 ..	200,000.00	100,000.00
		<u>\$600,000.00</u>
Capital .....	\$500,000.00	
Note payable .....	100,000.00	
		<u>600,000.00</u>
General income, net .....	\$50,000.00	taxable
Interest on bonds .....	15,000.00	exempt
Gain on sale of bonds .....	5,000.00	taxable
	<u>\$70,000.00</u>	
Interest paid on average borrowings during year, \$150,000 at 5 per cent .....	7,500.00	not deductible
Net income per books .....	<u>\$62,500.00</u>	
Taxable income .....	<u>\$55,000.00</u>	



**Inadmissible assets not to be deemed to be inadmissible.—**

By reason of profit on sale:

Interest received on bonds sold....	\$10,000.00
Gain received on bonds sold.....	5,000.00
	<u>\$15,000.00</u>

Bonds sold .....	\$200,000.00
5/15 of \$200,000.....	\$66,666.00

By reason of interest paid:

Interest received on bonds as col-	
lateral, \$200,000 at 5 per cent..	10,000.00
Interest paid on loans.....	7,500.00
Ratio of interest paid to interest received 75 per cent.	
75 per cent of \$200,000.....	<u>150,000.00</u>

Total not to be deemed to be inadmissible .....	<u>\$216,666.00</u>
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Average of inadmissible assets for year <sup>1</sup> .....	\$300,000.00
Not to be deemed to be inadmissible.....	<u>216,666.00</u>

Inadmissible .....	\$83,334.00
Admissible .....	\$500,000.00
Add .....	<u>216,666.00</u>
	<u>716,666.00</u>

Total assets.....	<u><u>\$800,000.00</u></u>
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Capital .....	\$500,000.00
Deduction under Section 326 (c), 83,334/800,000 of \$500,000.....	<u>52,084.00</u>

Net invested capital.....	<u><u>\$447,916.00</u></u>
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Taxable income .....	\$55,000.00
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War profits credit:

10 per cent .....	\$44,791.60
Specific exemption .....	<u>3,000.00</u>
	<u>47,791.60</u>

Subject to tax .....	<u><u>\$7,208.40</u></u>
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Tax 80 per cent .....	<u><u>\$5,766.72</u></u>
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<sup>1</sup>Bonds sold December 31. Calculation for one day omitted.

**Interest restriction applies only to bonds.**—In connection with the foregoing illustrations it will be noted that when money is borrowed to buy or carry corporate stocks the interest paid in respect thereof is an allowable deduction [Section 234 (a-2)], hence the provision in Section 325 (a) whereby inadmissible assets may be deemed not to be inadmissible applies to gains from the sale of corporate stocks but does not apply to interest paid in respect thereof.

Page 725

**Changes in invested capital.**—When changes occur in invested capital during the taxable year, either because of a change in the proportion of admissible and inadmissible assets or when the capital is increased or diminished, invested capital during the year must be averaged. In certain cases the calculation may be made by adding the amounts of capital at the beginning and end of the year and dividing by two but in other cases the calculation must be based on the dates of each change. The following regulations cover the procedure.

#### PERCENTAGE OF INADMISSIBLE ASSETS.—

**REGULATIONS.** For the purpose of ascertaining the deductible percentage the amount of inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount held at the end of the year. The total amount of admissible and inadmissible assets held during the year may ordinarily be determined by dividing by two the sum of the amount of such assets held at the beginning of the year and the amount at the end of the year. If at any time a substantial change has taken place either in the amount of inadmissible assets or in the total amount of admissible and inadmissible assets, the effect of such change shall be averaged exactly from the date on which it occurred. In any case where the Commissioner finds that either amount determined as above provided does not substantially reflect the average situation throughout the year, and that the amount of each kind of assets held on a given day of each month throughout the year or at more frequent regular intervals can be determined, the amount of inadmissible assets and the amount of both kinds of assets held during the year shall be determined by averaging the amounts held at such several times. In mak-

# ILLUSTRATION OF CHANGES IN INVESTED CAPITAL DURING YEAR

RETURN OF CORPORATION FOR CALENDAR YEAR ENDING DECEMBER 31, 1918

Reg. 45, Art. 853

PAGES			FORM 1120 SCHEDULE & ITEM	
	ADDITION TO INVESTED CAPITAL			
	February 27, 1918	Paid in \$100,000.00	318 days = $\frac{100,000 \times 318}{365}$ = .....	\$87,123.29 H - 1-Cols. 2, 5, 6, 7
		DEDUCTION FROM INVESTED CAPITAL		
	October 31, 1918	Withdrawn \$50,000.00	62 days = $\frac{50,000 \times 62}{365}$ = .....	\$ 8,493.15 H - 2-Cols. 2, 5, 6, 7

725 Instructions on Form 1102 (Schedule H) read: "Specify (by using red ink for distributions or otherwise) whether each item represents an addition or distribution."

# ILLUSTRATION OF RETURN FOR FRACTIONAL PART OF YEAR

CORPORATION ORGANIZED JULY 1, 1918, MAKING RETURN FOR 6 MONTHS ENDING DECEMBER 31, 1918

Reg. 45, Art. 856

PAGES		Paid in	No. DAYS EFFECTIVE	FORM 1120 SCHEDULE & ITEM	
July 1, 1918	Paid in	.....	100,000 X 92	\$100,000.00	
Oct. 1, 1918	Paid in \$100,000.00	92 days =	$\frac{100,000 \times 92}{184}$	50,000.00	H - 1-Cols. 2, 5, 6, 7
				<u>\$150,000.00</u>	

701, 725

The addition to Invested Capital for \$100,000 paid in October 1, 1918 is effective for exact number of days, October 1, 1918, to December 31, 1918 (92) in proportion to number of days in period covered by return (184).  
Invested Capital for purpose of the tax is then figured on the basis of the proportion of the number of days covered by the return to 365 days, which is  $\frac{184}{365}$ .

$\frac{184}{365}$  of \$150,000 = Invested Capital for purpose of tax.....  
\$75,616.44

ing the computations under this article the valuation at which each asset is carried shall be adjusted in accordance with the provisions of the statute and of the regulations relating to the valuation of assets for the purpose of computing invested capital. It is immaterial whether such assets were acquired out of invested capital or out of profits earned during the year or borrowed capital. (Reg. No. 45, Article 852.)

**CHANGES IN INVESTED CAPITAL DURING YEAR.—**

The invested capital as of the beginning of any period of one year or less should be adjusted by an appropriate addition or deduction for each change in invested capital during the period. The amount so added or deducted in each case is the amount of the change averaged for the time remaining in the period during which it is in effect. The fraction used in finding such average is the number of days remaining in the period (including the day on which the change occurs) over the number of days in the period. . . . (Reg. No. 45, Article 853.)

Page 725

**Inadmissible assets purchased out of current earnings.—**

In Article 852 as above it is stated that in arriving at the percentage of inadmissible assets to be deducted, the amount held during the year must be taken into consideration. The article also states that it is immaterial if such assets were purchased out of profits earned during the year.

A corporation at the beginning of the year may have held no inadmissible assets. At the middle of the year out of funds readily identified as arising out of current profits it purchased corporate stocks. No dividends thereon were received up to the end of the year. If the amount invested in the stocks is averaged with other assets there will be deducted from invested capital *at the beginning of the year* a percentage thereof.

The tax on the income from other sources depends on the credit of 8 or 10 per cent. If the invested capital is decreased because of the purchase of corporate stocks, the tax will be increased. This result is not equitable. The law does not contemplate that current earnings shall be taken into consideration during the year by adding such earnings to invested capital. If inadmissible assets purchased during the year out of

current earnings must be averaged, it would in effect result in the *deduction* of current earnings from invested capital at the beginning of the year. Therefore, when inadmissible assets can be identified as having been purchased out of current earnings, the amount invested therein should be omitted from the computation of deductions from invested capital. This rule applies whether or not income is received therefrom.

**Stock of Federal Reserve bank is an inadmissible asset.**—As dividends from the stock of a Federal Reserve bank are not subject to the excess profits tax, the capital invested in such stock is an inadmissible asset. As stated on page 725, there is only one exception to the rule that all assets the income from which is tax-exempt are inadmissible. That exception is United States obligations. Stock of a Federal Reserve bank is not an obligation of the United States.

Page 728

**Treasury stock.**—The new regulations are in agreement with the text as to the necessity for excluding treasury stock, except when stock is purchased during the taxable year out of undivided profits of the year.

**PURCHASE OF STOCK.**—

**REGULATION.** Where a corporation either directly or indirectly, as for example through a trustee, has prior to the taxable year bought its own stock, either for the purpose of retirement or of holding it in the treasury or for other purposes, the entire cost of such stock must be deducted from the aggregate invested capital as of the beginning of the taxable year, if such deduction has not already been made. Where such stock is purchased during the taxable year a deduction from the invested capital as of the beginning of the taxable year and effective from the date of such purchase is required only to the extent that such stock has not been purchased out of the undivided profits of the taxable year. The full amount derived in cash or its equivalent from the resale of such stock may be included in the invested capital from the date of such resale. (Reg. No. 45, Article 862.)

The foregoing provision as to the treatment of treasury stock purchased out of current earnings merely applies the

general rule. An increase in the bank account which may arise out of uninvested current earnings would not add anything to the invested capital. Consequently no exchange of cash for any other kind of an asset would affect invested capital during the year. (See page 730.)

Page 728

**Bonus stock.**—Article 832, Reg. No. 45, is as follows:

**REGULATION.** Capital stock issued as a bonus in connection with the sale of a corporation's bonds may not be included in invested capital unless the corporation proves to the satisfaction of the Commissioner that such stock bonus enabled the corporation to secure a higher price for the bonds than it could otherwise have secured. Wherever this fact is established such stock shall be included in computing invested capital to the extent of the difference between the selling price of the bonds and the price at which they could have been sold if issued without such stock bonus. The excess of the face value of such bonds over the price at which they could have been sold if issued without the stock bonus is deemed discount and is subject to amortization. (Reg. No. 45, Article 832.)

The foregoing regulation is not entirely clear. There cannot be any such thing as bonus stock in most states unless it has first been issued full paid for property. It would therefore seem that the discussion in this book and in the regulations regarding the valuation of assets and the limitations on intangible property would cover any possible cases in which bonus stock might be involved. It may be assumed that the regulation merely points out the method of arriving at the cash value of the property which appears on the books as an offset to the bonus stock. If, however, the property has been otherwise valued on its merits or if all or part of it has been excluded because of its intangible nature, the computation involved in the foregoing article is rather difficult.

Page 730

**Surplus arising from revaluations—property taken for debt.**—

**REGULATION.** Real or personal property taken by a corporation in payment or satisfaction of a debt cannot be included as an admis-

sible asset or reflected in the surplus account at an amount in excess of either (a) its actual value as of the beginning of the taxable year or (b) the amount of the debt in payment of which it was taken. (Reg. No. 45, Article 847.)

The foregoing regulation merely confirms the general rule that appreciation cannot be included in invested capital. If the value of the property taken over is in excess of its cost and its value is written up, the current profit and loss account must be credited in order that the increased value will be reflected in invested capital commencing with the beginning of the succeeding year.

Page 731

**Paid-in surplus.**—The new regulations give details regarding evidence to be submitted in substantiation of a claim for paid-in surplus.

**TANGIBLE PROPERTY PAID IN: VALUE IN EXCESS OF PAR VALUE OF STOCK.**—

**REGULATIONS.** Evidence offered to support a claim for a paid-in surplus must be as of the date of the payment, and may consist among other things of (a) an appraisal of the property by disinterested authorities made on or about the date of the transaction; (b) certification of the assessed value in the case of real estate; and (c) proof of a market price in excess of the par value of the stock or shares. The additional value allowed in any case is confined to the value definitely known or accurately ascertainable at the time of the payment. No claim will be allowed for a paid-in surplus in a case in which the additional value has been developed or ascertained subsequently to the date on which the property was paid in to the corporation, or in respect of property which the stockholders or their agents on or shortly before the date of such payment acquired at a bargain price, as for instance, at a receiver's sale. Generally, allowable claims under this article will arise out of transactions in which there has been no substantial change of beneficial interest in the property paid in to the corporation, and in all cases the proof of value must be clear and explicit. (Reg. No. 45, Article 836.)

**SURPLUS AND UNDIVIDED PROFITS.**—

Where it is shown by evidence satisfactory to the Commissioner that tangible property has been paid in by a stockholder to a corporation as a gift or at a value definitely known or accurately ascertainable as of the date of such payment clearly and substantially in excess



of the cash or other consideration paid by the corporation therefor, then the amount of the excess shall be deemed to be paid-in surplus. Substantially the same kind of evidence will be required under this article as under Article 836. (Reg. No. 45, Article 837.)

Page 733

### **Increase in capital through dividends.—**

#### **SURPLUS AND UNDIVIDED PROFITS: CURRENT PROFITS.—**

**REGULATION.** Profits earned during any year cannot be included in the computation of invested capital for that year, even though during the year such profits are set up as surplus on the books or assumed to be distributed in the form of stock dividends. If a dividend is declared and paid during any year out of the profits of that year and the stockholders pay back into the corporation all or a substantial part of the amount of such dividends, the amount so paid back cannot be included in the computation of invested capital unless the corporation shows by evidence satisfactory to the Commissioner that the dividends were paid in good faith and without any understanding, express or implied, that they were to be paid back. (Reg. No. 45, Article 850.)

**Decrease in capital through dividends.—**The new regulations provide that a dividend paid after the expiration of the first 60 days of the taxable year reduces invested capital as of the first of the year to the extent, if any, which the earnings for the year are insufficient to pay the dividend. If payments had been made to stockholders in anticipation of the dividend the payments reduce invested capital in the same manner as a dividend would operate to reduce invested capital.

#### **EFFECT OF ORDINARY DIVIDENDS.—**

**REGULATION.** A dividend other than a stock dividend affects the computation of invested capital from the date when the dividend is payable and not from the date when it is declared, except that where no date is set for its payment the date when declared will be considered also the date when payable. For the purpose of computing invested capital a dividend paid after the expiration of the first sixty days of the taxable year will be deemed to be paid out of the net income of the taxable year to the extent of the net income available for such purpose on the date when it is payable. The surplus and undivided profits as of the beginning of the taxable year will be reduced as of the date when the dividend is payable by the entire amount of any dividend paid during the first sixty days of the taxable

year and by the amount of any other dividend in excess of the current net income available for its payment. From the date when the dividend is payable the amount which the several stockholders are entitled to receive will be treated as if actually paid to them, whether or not it is so paid in fact, and the surplus and undivided profits, either of the taxable year or of the preceding years, will in accordance with the foregoing provisions be deemed to be reduced as of that date by the full amount of the dividend. Amounts paid to stockholders in anticipation of dividends, or amounts withdrawn by stockholders in excess of dividends declared, will in computing invested capital have the same effect as if actually paid as dividends. (Reg. No. 45, Article 858.)

**Page 734**

**Method of determining income available for dividends.—**

Article 857 of Reg. No. 45, provides that net income of a taxable year will be deemed to be allocated (a) to federal taxes, (b) to dividends paid after the expiration of the first sixty days. In the event that dividends are in excess of the net income after allowing for federal taxes and if the payment of such dividends decreases the invested capital at the beginning of the year, then the net earnings for the year would be affected, because the amount of invested capital would be reduced, federal taxes would be increased and the amount available for dividends would be decreased. This calculation would require the use of a formula somewhat on the order of the one on page 1079.

**Page 735**

**RESERVES FOR DEPRECIATION AND DEPLETION.—**It has been assumed by the author that reserves for depreciation should not be considered as such in connection with a computation of invested capital because when a reserve for depreciation and depletion is correct, it is in fact deductible from the asset accounts. When the reserves are correct but when amounts added thereto in previous years were not allowed as depreciation by the Department, the procedure is the same as that indicated for bad debts on page 735. When excessive depreciation has been charged off and plant accounts are readjusted,

the credit arising out of such restoration belongs in surplus account and not in depreciation reserves.

When the reserve for depreciation or depletion includes any restoration of appreciation set up as of March 1, 1913, the amount should be transferred to earned surplus. The following regulations bear out the comments of the author.

**REGULATIONS.** If any reserves for depreciation or for depletion are included in the surplus account it should be analyzed so as to separate such reserves and leave only real surplus. Reserves for depreciation or depletion cannot be included in the computation of invested capital, except to the following extent:

(1) Excessive depletion or depreciation included therein and which if charged off could be restored under Article 840 may be included in the computation of invested capital; and

(2) Where depreciation or depletion is computed on the value as of March 1, 1913, or as of any subsequent date, the proportion of depreciation or depletion representing the realization of appreciation of value at March 1, 1913, or such subsequent date, may if undistributed and used or employed in the business be treated as surplus and included in the computation of invested capital.

For the purpose of computing invested capital depreciation or depletion computed on the value as of March 1, 1913, or as of any subsequent date shall, if such value exceeded cost, be deemed a pro rata realization of cost and appreciation and be apportioned accordingly. Except as above provided value appreciation (even though evidenced by an appraisal) which has not been actually realized and reported as income for the purpose of the income tax cannot be included in the computation of invested capital, and if already reflected in the surplus account it must be deducted therefrom. (Reg. No. 45, Article 844.)

#### ALLOWANCE FOR DEPLETION AND DEPRECIATION.—

Depletion, like depreciation, must be recognized in all cases in which it occurs. Depletion attaches to each unit of mineral or other property removed, and the denial of a deduction in computing net income under the act of August 5, 1909, or the limitation upon the amount of the deduction allowed under the act of October 3, 1913, does not relieve the corporation of its obligation to make proper provision for depletion of its property in computing its surplus and undivided profits. Adjustments in respect of depreciation or depletion in prior years will be made or permitted only upon the basis of affirmative evidence that as at the beginning of the taxable year the amount of depreciation or depletion written off in prior years

was insufficient or excessive, as the case may be. Where deductions for depreciation or depletion have either on the books of the corporation or in its returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return. (Reg. No. 45, Article 839.)

Page 736

**Reserve for taxes.**—Article 845, Reg. No. 45, confirms T. D. 2791, February 17, 1919. It should be noted that invested capital as of the beginning of the year is reduced not on the date or dates when taxes are paid but on the date or dates when taxes are payable. Therefore no matter when the taxes for the taxable year 1918 are paid, invested capital will also be reduced on the dates when the several instalments become due and *payable*.

It has been contended that the foregoing rule is inequitable. As a matter of fact if any change is made therein in all probability it will be held that as of the end of the taxable year the full amount of taxes payable becomes a liability and as such reduces the invested capital as of the beginning of the succeeding taxable year.

Page 740

**Invested capital—restoration of excessive depreciation.**—

As stated on page 750, plant accounts may be adjusted when excessive depreciation has been written off. The following rules must be observed:

**SURPLUS AND UNDIVIDED PROFITS: ADDITIONS TO SURPLUS ACCOUNT.**—

**REGULATION.** A corporation's books of accounts will be presumed to show the facts. If it claims that its capital or surplus account is understated the burden of proof will rest upon it. Additions to such accounts will be accepted to the following extent:

(1) Excessive depreciation heretofore charged off on property still in use, if it is now shown by satisfactory proof to have been

excessive and such excess is substantial in amount, whether or not disallowed by the Commissioner as a deduction from net income, may be restored to the surplus account. No such amount shall be restored, however, unless it is shown that adequate depreciation has been deducted upon all other property of the corporation still in use, nor in any case in which such amount has been allowed as a deduction for amortization under Section 234 (a-8) of the statute, or in which the cost of the property has been recovered through being included in the price of goods or services, as for example, in the case of patterns, dies, plates, special tools, etc., or under a munition contract with a foreign government.

(2) Amounts which have been expended before January 1, 1917, for the acquisition of plant, equipment, tools, patterns, furniture, fixtures or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper deductions for depreciation or obsolescence) be added to the surplus account when such assets are still owned and in active use by the corporation during the taxable year. Special tools, patterns and similar assets shall not be assigned any value if their cost has been recovered through having been included in the price of goods. If their cost has not been so recovered and they are held for only occasional use, they shall not be assigned a value in excess of the fair value based upon the earnings actually arising from their current use, and in no case shall such value be more than the cost less depreciation. Assets of this kind not in current use shall not be valued at more than their nominal or scrap value.

(3) Amounts which have been expended in the past for intangible property of any kind can be restored to capital or surplus account only to the extent that the corporation specifically paid such amounts for the intangible property as such.

(4) Adjustments necessary to correct other errors found in the books of account may be made. But see the following article. (Reg. No. 45, Article 840.)

#### SURPLUS AND UNDIVIDED PROFITS: LIMITATION OF ADDITIONS TO SURPLUS ACCOUNT.—

REGULATION. Additions to surplus which a corporation may desire to make under the preceding article fall broadly into two classes:

(1) To correct returns of net income for prior years in which actual errors have been made, as for example where excessive depreciation has been deducted, additions to plant and equipment or other capital charges have been charged off as an expense, inventories have been taken upon a wrong basis of valuation, etc.

(2) To reinstate in surplus deductions from income which are a matter of good accounting to some extent optional, such as experi-

mental expenses, patent litigation, development of goodwill through advertising or otherwise, etc.

Adjustments falling in class (1) will be permitted for all years whether before or after March 1, 1913, provided amended returns of net income are filed for each year in which an erroneous return has been made. Due consideration will be given to the assessment of penalties in any case in which a fraudulent return has been made. Adjustments falling in class (2) cannot be permitted, as in such cases it is considered that the corporation has exercised a binding option in deducting such expenses from income. An election of this sort which was made concurrently with the transaction cannot now be revised, and amended returns in respect thereof cannot be accepted. The corporation shall submit with its return a statement of the additions proposed, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses, and showing that adequate provision has been made for depreciation, obsolescence and depletion of such of the assets affected by the additions as are subject to recognized depreciation, obsolescence or depletion. In any case in which there is an operating deficit amounts restored must first be set off against the deficit and only the excess can be actually included in the computation of invested capital. (Reg. No. 45, Article 841.)

Generally speaking, the adjustments contemplated by the foregoing articles are those which would be made in any event by public accountants under instructions to restate the accounts of a corporation upon a basis which reflects actual assets, actual liabilities and actual net profits. Adjustments are not permitted when methods sanctioned by good accounting practices have been followed. It is recognized that when the determination of true invested capital is necessary, no corporation should be penalized for having been ultra-conservative in past years. The article limits the adjustment of plant accounts to items acquired before January 1, 1917. As of that date an excess profits tax law, requiring the determination of invested capital, became effective and it is fair to assume that accounts for the period since January 1, 1917, have properly differentiated between capital and income.

Page 754

**Definition of intangible property.**—The new regulations hold that most contracts, subscription lists, etc., are intangible

property. The Department, however, recognizes the fact that a contract may be tangible property. The regulation holds that Associated Press and similar franchises are intangible property.

REGULATION. "Intangible property" includes patents and goodwill and other like property. "Tangible property" includes all property other than intangible property. Most contracts are intangible property and in the absence of a specific ruling by the Commissioner to the contrary should be so regarded for the purpose of making returns. A contract may be treated as tangible property only after the submission of a full statement as to its exact nature showing to the satisfaction of the Commissioner that it relates to rights in tangible property to such an extent that its value arises chiefly therefrom. Associated Press, United Press and similar franchises, and subscription lists and mailing lists, are intangible property. (Reg. No. 45, Article 811.)

It should be noted, as stated on page 721, that intangible property purchased for cash is to be included in invested capital at full value. The restriction on the inclusion of intangible assets applies only when such assets were acquired for stock.

Page 756

**Patents.**—The new regulations contain explanation as well as directions in respect of the treatment of patents.

REGULATION. From the standpoint of assets a patent, or more particularly a group of patents, is closely analogous to goodwill. Their value is contingent upon and measured by their earning power. While patents have a definite life there is a common tendency to extend that life by improvements upon the original, and in a successful business the patent value merges more or less completely into a trade-name or other form of goodwill. Therefore, while deductions in respect to the depreciation of patents based upon a normal life period of seventeen years are allowable in computing net income for the purpose of the income tax, such deductions are not obligatory, but are optional with each taxpayer. Where since January 1, 1909, a corporation has exercised that option to its own benefit in computing its taxable net income the amount so deducted cannot now be restored in computing invested capital. Where, however, the cost of patents has been charged against surplus or otherwise disposed of in such a manner as not to benefit the corporation in computing its taxable net income since January 1, 1909, any amount so written off may be restored in computing invested capital, if it be shown to the satisfaction of the Commissioner that the amount so written

off represented a mere book entry ascribable to a conservative policy of management or accounting and did not represent a realized shrinkage in the value of such assets. Any amount so restored may not be written off by way of deductions from taxable net income in any subsequent year or years. Where a corporation has charged to current expenses the cost of developing or protecting patents, no amount in respect thereof expended since January 1, 1909, can be restored in computing invested capital. In respect of expenditures made before January 1, 1909, a corporation now seeking to restore them must be prepared to show to the satisfaction of the Commissioner that all such items are proper capital expenditures. It cannot be said that the correct computation of surplus and undivided profits necessarily requires a deduction in respect of the expiration of patents. It follows, therefore, that where a corporation in the exercise of its option has not written down the cost of patents, it is not ordinarily necessary to reduce the surplus and undivided profits in computing invested capital, whether the patents have been acquired for stock or shares or for cash or other tangible property. Due consideration will be given to the facts in any case in which this rule seems obviously unreasonable. (Reg. No. 45, Article 843.)

## CHAPTER XXXIV

### WAR AND EXCESS PROFITS TAXES

#### ADJUSTMENT OF NET INCOME; REORGANIZATIONS; PRE-WAR INVESTED CAPITAL AND NET INCOME

Page 762

**Adjustment of net income for pre-war period.**—It should be noted that the statement on page 762 applies only to the pre-war period and has nothing whatever to do with the adjustment of net income for the taxable year. The reference to the 10 per cent rate on average invested capital is intended to make clear the fact that if the net income of the pre-war period was less than 10 per cent, it is not necessary to make any calculation of the actual net income for the pre-war period.

Page 765

**Pre-war net income of affiliated corporations.**—In order



that there may be a correct basis of comparison between the consolidated statements for the taxable year and for the pre-war period, the regulations provide that a proper adjustment be made for the pre-war period.

**REGULATION.** The consolidated net income of affiliated corporations for the pre-war period shall be the aggregate of the average net income for the pre-war years of such of the several corporations included in the consolidation for the taxable year, whether or not affiliated during such pre-war period, as were in existence during all the pre-war period or during at least one full year of the pre-war period. (Reg. No. 45, Article 802.)

Page 768

**Scope of reorganizations.**—It should be noted that extracts from Section 330 of the law referred to on page 768 refer only to the pre-war period.

**REGULATIONS.** The first two paragraphs of Section 330 of the statute relate only to the pre-war period and not to the invested capital or net income for the taxable year. Under their provisions in the case of a reorganization, consolidation or change of ownership, the corporation is regarded as having been in existence prior to the date of such reorganization, consolidation or change in ownership, and the net income and invested capital of the predecessor trade or business for all or any part of the pre-war period prior to the organization of the present corporation are deemed to have been the net income and invested capital of such corporation. (Reg. No. 45, Article 931.)

**NET INCOME AND INVESTED CAPITAL OF PREDECESSOR PARTNERSHIP OR INDIVIDUAL.—**

If the predecessor trade or business was carried on by a partnership or individual, the corporation shall make its return of the net income and invested capital of such trade or business as nearly as may be in the same manner as if such trade or business had been carried on by a corporation. It shall submit with its return a statement setting forth (a) the manner in which such trade or business was carried on and (b) the points, if any, in which the provisions of the statute and of the regulations are not fully applicable to the determination of the net income or invested capital of the predecessor trade or business for the pre-war period. In no case shall the deduction from gross income for salary or compensation for personal services exceed the salaries or compensation customarily paid at that

time by corporations or partnerships of similar size and standing engaged in like or similar trades or businesses for similar services under like responsibilities. (Reg. No. 45, Article 932.)

Page 769

**Reorganizations after March 3, 1917.—**

**VALUATION OF ASSET UPON CHANGE OF OWNERSHIP.—**

**REGULATION.** Where a business is reorganized, consolidated or transferred, or property is transferred, after March 3, 1917, and an interest of 50 per cent or greater in such business or property remains in any of the previous owners, then for the purpose of determining invested capital each asset so transferred is valued (a) as if still in the possession of the previous owner, if a corporation, or, if not a corporation, (b) at its cost to such previous owner, with proper adjustments for losses and improvements. This provision is accordingly concerned with the computation of invested capital for the taxable year, while Section 330 of the statute is chiefly concerned with the determination of invested capital for the pre-war period. (Reg. No. 45, Article 941.)

Page 772

**When invested capital and net income of pre-war period need not be determined.—**If the net income for the taxable year is less than 10 per cent of the invested capital for the taxable year (plus the \$3,000 exemption), it is not necessary to ascertain the invested capital or the net income for the pre-war period because no matter how large or how small it may have been there will be no war profits tax to pay upon the net income for the taxable year. The credit of 10 per cent for the taxable year will at least be sufficient to eliminate any liability to the war profits tax. If the net income for the taxable year is more than 8 per cent (plus the \$3,000 exemption) and less than 10 per cent, there will be an excess profits tax to pay, in which case the invested capital and net income for the pre-war period have no bearing on the computation of the tax.

## CHAPTER XXXV

EXCESS AND WAR PROFITS TAXES  
WHEN INVESTED CAPITAL CANNOT SATISFAC-  
TORILY BE DETERMINED

Page 777

**Relief sections.**—The new regulations deal with relief Sections 327 and 328 as follows:

**TREATMENT OF SPECIAL CASES.**—

**REGULATIONS.** In the cases specified in Section 327 of the statute the tax will be specially determined under the provisions of Section 328, but the tax will not ordinarily be computed under Section 328 merely because the corporation's form or manner of organization, or the limitations imposed by Section 326, result in a greater tax than would otherwise be payable. A corporation which comes within the provisions of subdivision (d) of Section 327 may make application for assessment under the provisions of Section 328, which application shall be attached to its return in the form of a statement setting forth in full: (a) the reasons why the tax should be so determined; (b) the facts upon which such reasons are based; (c) an exact description of each trade or business or important branch of a trade or business carried on by it; (d) a statement of the invested capital and net income for each year since the beginning of the pre-war period; and (e) a statement showing the amount of gains, profits, commissions or other income derived on a cost plus basis from government contracts made after April 5, 1917, and before November 12, 1918, and showing the per cent which such income is of the total income of the corporation. (Reg. No. 45, Article 901.)

**COMPUTATION OF TAX IN SPECIAL CASES.**—

In the cases specified in Section 327 of the statute the tax is to be computed by comparison with representative corporations whose invested capital can be satisfactorily determined under Section 326 and which are engaged in a like or similar trade or business and similarly circumstanced. The provisions of Section 328 do not permit the determination of a general average for any trade or business. In each case which comes under the provisions of Section 327 the Commissioner will determine, as nearly as may be, the group or class of corporations with which the corporation should be compared and the amount which bears the same ratio to the net income of the corporation (in excess of the specific exemption of \$3,000) for the

taxable year as the average tax of such representative corporations bears to their average net income (in excess of the specific exemption of \$3,000) for such year. The comparison will take account of similarity with respect to gross income, net income, profit per unit of business transacted, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances. (Reg. No. 45, Article 911.)

The 3 forms following are designed to meet the requirements of all domestic corporations, except personal service corporations (Sec. 218, c, and 315, c), corporations that conduct business in part of the character engaged in by personal service corporations (Sec. 303), corporations subsidiary to corporations that make returns on the basis of consolidated statements, corporations making returns for a period less than twelve months in the process of changing the fiscal year (Sections 226, 239, 305 and 311), insurance companies, and certain organizations specifically exempted from Federal income taxes. (Sec. 231).

**RECONCILEMENT OF BOOK NET INCOME  
WITH  
NET INCOME SUBJECT TO INCOME, EXCESS AND WAR PROFITS TAXES**

Taxable Year Ended.....1918

IF FISCAL YEAR IS CALENDAR YEAR USE COLUMN A ONLY AND IGNORE COLUMN B	A FOR ALL CORPORATIONS	B FOR CORPORATIONS WHOSE FISCAL YEARS ARE NOT CALENDAR YEAR
The two money columns are provided to classify net income in accordance with the varying definitions governing the income and excess profits tax returns of corporations for fiscal years ending in 1918. A corporation whose fiscal year is the calendar year would use column A only. A corporation whose fiscal year is not the calendar year would use columns A and B. Figures in both columns should be for the full fiscal year; that is, for 12 months. The net totals of each column should be carried to page 3 where taxes will be computed on each as follows: Column A. Income and excess profits taxes at 1918 rates (upon amount apportioned to 1918 if fiscal year is not calendar year). Column B. Income and excess profits taxes at 1917 rates upon amount apportioned to 1917 (except that excess profits tax for holding or controlling company would be determined from consolidated income statement as explained in footnote 1.)	1918 BASIS Consolidated (a) figures to be used if corporation is holding or controlling company	1917 BASIS Figures not to be consolidated used if corporation is holding or controlling company
1. Net income for fiscal year according to the books (any income and expense items entered in Surplus Account during the year should be combined with Profit and Loss Accounts).....	.....	.....
Add expenses charged on the books but not deductible on Tax Return:	.....	.....
2. Federal income and excess profits taxes (also foreign income and excess profits taxes in col. A) (p. 477, 472).....	.....	.....
3. Taxes assessed against local benefits if value of property is increased (p. 472).....	.....	.....
4. Amounts reserved for uncollectible accounts or bad debts (p. 527).....	.....	.....
5. Amounts reserved for losses and contingencies other than depreciation and depletion and uncollectible accounts (p. 735).....	.....	.....
6. Premiums paid for life insurance (less any rebates) (p. 432).....	.....	.....
7. Donations paid which are actual gifts (p. 424).....	.....	.....
8. Payments in excess of reasonable compensation to officers who are stockholders (p. 414).....	.....	.....
9. Interest paid on indebtedness incurred to purchase tax exempt securities and 4% and 4½% Liberty Bonds (for 1917 basis only) (p. 448).....	xx xxx xxx xx	.....
10. Interest paid or accrued on indebtedness incurred or continued to purchase or carry tax exempt securities other than 4% and 4½% Liberty Bonds (for 1918 basis only) (p. 448).....	.....	xx xxx xxx xx
11. Interest paid on an amount of indebtedness in excess of capital stock plus ½ interest-bearing indebtedness outstanding at end of fiscal year, (unless covered by No. 9) (p. 455).....	xx xxx xxx xx	.....
12. Amortization that is allowable in 1918 but not in 1917 (p. 585).....	xx xxx xxx xx	.....
13. Adjustment of book gain or loss on sale of capital assets in reckoning from value at March 1, 1913 (p. 254) if an addition.....	.....	.....
14. Add income not credited as such on the books, but taxable:	.....	.....
15. Proceeds of life insurance policies less premiums paid (p. 235).....	.....	.....
16. Total (sum of items 1 to 15).....	.....	.....
Deduct: Income credited on the books but not taxable:	.....	.....
17. Dividends received from domestic corporations (1917 exception is covered by item 235 (p. 325)).....	.....	.....
18. Proportion of dividends received from any foreign corporation equal to ratio of net income derived in United States to total net income (p. 725).....	.....	.....
19. Interest on oil and gas and political subdivisions thereof (also territories in 1918) (p. 58).....	.....	.....
20. Interest on Liberty Bonds, bonds of the War Finance Corporation and other federal obligations (p. 295).....	.....	.....
21. Credits to establish Cash Surrender Value of life insurance policies (p. 432).....	.....	.....
22. Refunds of federal income and excess profits taxes over-assessed (p. 146).....	.....	.....
23. Gifts received (p. 233).....	.....	.....
24. Gains accrued prior to March 1, 1913 (p. 261).....	.....	.....
25. Adjustment of book gain or loss on sale of capital assets in reckoning from value at March 1, 1913 (p. 254) if a deduction.....	.....	.....
26. ....	.....	.....
27. ....	.....	.....
28. ....	.....	.....
Items not charged to Profit and Loss Accounts but deductible on tax return:	.....	.....
29. Bad debts charged less recoveries credited to Reserve Account (p. 735).....	.....	.....
30. Losses actually sustained charged to Reserve Accounts (p. 735).....	.....	.....
31. ....	.....	.....
32. ....	.....	.....
33. ....	.....	.....
34. ....	.....	.....
35. Total adjustments to be deducted (sum of items 17 to 34).....	.....	.....
36. Net income subject to income tax (item 16 minus item 35).....	A36	B36
37. Add: Interest on Liberty Bonds and Certificates of Indebtedness and Bonds of the War Finance Corporation in excess of special exemptions (p. 300) (as determined by the method defined in forms on pages 1104 and 1105).....	.....	.....
38. Total (item 36 plus item 37).....	.....	.....
39. Deduct: Interest paid on indebtedness incurred to purchase 4% and 4½% Liberty Bonds with respect to which interest is reported on line 9, but total allowable interest deduction must not be exceeded (p. 448).....	xx xxx xxx xx	.....
40. Net income (item 38 minus item 39) subject to excess profits tax (3).....	A40	B40

(1) Consolidated Statements: If corporation is a holding or controlling company, the figures in column A should represent the specified items of income and expense as shown by the consolidated profit and loss statement.

If corporation is a holding or controlling company with fiscal year ending at date other than December 31, the figures in column B on this sheet should not be consolidated. Consolidated figures would be needed, however, for determination of the excess profits tax and for this purpose the amounts should be set up on another sheet following the same classification as in column B. See note c following item 225, page 3.

(2) But not including the net income of any affiliated corporation organized after August 1, 1914, and not successor to a then existing business, 50 per cent or more of whose gross income was derived from Government contracts or sub-contracts made between April 6, 1917, and November 11, 1918. Such corporation shall be assessed separately. (Sec. 240.)

(3) In the case of any corporation engaged in the mining of gold, the portion of net income derived therefrom shall be exempt from war-profits and excess-profits taxes beginning January 1, 1918. (Sec. 304.)

Excess profits tax on proceeds from the sale of mines, oil and gas wells, or any interest therein, shall not exceed 80 per cent of the selling price. (Sec. 337.)

# RECONCILEMENT OF BOOK CAPITAL WITH INVESTED CAPITAL AS DEFINED IN THE 1918 LAW

Taxable Year Ended... 1918

If fiscal year is calendar year, use column C only. Corporations whose fiscal years are not the calendar year should enter figures in both columns. Corporations which are holding or controlling companies must use consolidated figures. The article numbers cited below refer to Treasury Department Regulations No. 45, 1919.		C 1918 BASIS For all Corporations (1)				D 1917 BASIS For Corporations whose fiscal years are not calendar year			
Invested Capital at beginning of fiscal year according to the books: (When stating total amount of invested capital according to the books disregard the asset side of the balance sheet.)									
101.	Capital Stock (p. 727).....								
102.	Premium realized on Capital Stock (p. 733).....								
103.	Surplus (while Surplus is added, any Deficit should not be deducted (pp. 729-732))								
Adjustments to be added:									
104.	Dividends Payable* (see item 135) (p. 733).....								
105.	Reserve for Accrued Preferred Stock Dividends* (see item 135) (p. 733).....								
106.	Reserve for Accrued Federal Income and Excess Profits Taxes* (see item 136) (Art. 845) (p. 736).....								
107.	Reserve for Uncollectible Accounts or Bad Debts* (p. 735).....								
108.	Reserve for Losses and Contingencies* (p. 735).....								
109.	.....								
110.	.....								
111.	Cash surrender value of life insurance if not on the books (p. 752).....								
112.	Cost less accrued depreciation of plant assets charged to Expense Account but still owned and in active use. (Art. 840) (pp. 740, 750-754).....								
113.	Depreciation charged on the books in excess of deductions allowed on tax returns (p. 735).....								
114.	Excess of actual value of tangible property at date acquired over book value at same date when acquired with stock (Art. 836) (p. 731).....								
115.	Excess of actual value of tangible property at date acquired over book value at same date when not acquired with stock (Art. 837) (p. 732).....								
116.	Excess of actual value at date acquired of tangible property acquired with stock after January 1, 1914, over book value at date acquired (Art. 55, Reg. 41, 1918) (p. 825).....	xx	xxx	xxx	xx				
117.	Excess of cash value at date acquired of intangible property purchased over book value at same date when not acquired with stock (Art. 840) (p. 721).....								
118.	Depreciation of goodwill, patents and copyrights, provided book value plus this adjustment does not exceed legal limitation (see items 127 and 128) (Art. 843) (p. 756).....								
119.	Proportion of permanent indebtedness corresponding with non-deductible interest (item 11) (Art. 53, Reg. 41, 1918) (p. 814).....	xx	xxx	xxx	xx				
120.	Federal Income and Excess Profits taxes refunded** (p. 736).....								
121.	Capital Stock (including any premium realized) added during fiscal year, exclusive of stock dividends, but including stock paid for out of special cash dividends (Art. 850) (pp. 727, 733).....								
122.	Inadmissible assets, being proportion thereof corresponding to gains on sales and non-deductible interest (Art. 817) (p. 722).....								
123.	Total (sum of items 101 to 122).....								
Adjustments to be deducted:									
124.	Portion of book value at date acquired of patents and copyrights acquired for stock in excess of cash value at same date (Art. 56, Reg. 41, 1918) (p. 826).....	xx	xxx	xxx	xx				
125.	.....								
126.	Portion of book value at date acquired of tangible property acquired for stock in excess of cash value at same date (Art. 831) (p. 720).....								
127.	Portion of book value at date acquired of goodwill, trade-marks, franchises or other intangible property purchased with stock issued prior to March 3, 1917, in excess of the lowest of the following figures: (a) 20% of par value of total stock outstanding March 3, 1917, or (b) actual value of asset at date acquired, or (c) par value of stock issued in payment therefor (Art. 57, Reg. 41, 1918) (p. 813).....	xx	xxx	xxx	xx				
128.	Portion of book value at date acquired of intangible property purchased with stock in excess of the lowest of the following figures: (a) actual value of assets at date acquired or (b) par value of stock issued therefor, or (c) 25% of par value of total stock outstanding March 3, 1917, or beginning of taxable year (Art. 851) (pp. 721, 754).....					xx	xxx	xxx	xx
129.	Excess of stocks and other inadmissible assets over permanent indebtedness (see Art. 45, Reg. 41, 1918) (pp. 816, 817).....	xx	xxx	xxx	xx				
130.	Treasury stock acquired by gift or for consideration substantially less than par (Art. 861) (p. 757).....								
131.	Depreciation, depletion and obsolescence not provided for on the books, except as covered by previous deductions (Art. 840) (p. 742).....								
132.	Value appreciation credited on the books not subject to income tax except as to part realized (Art. 844) (p. 739).....								
133.	Portion of book value of stock in foreign corporations corresponding with percentage which net income earned in United States is of entire net income (p. 755).....								
134.	Capital stock reduced during year by distributions to stockholders** (pp. 336-337)								
135.	Dividends paid during year out of earnings of prior years** (p. 734).....								
136.	Federal income and excess profits taxes as of date due and payable (Art. 845) (p. 736).....								
137.	Discounts on capital stock (p. 754).....								
138.	.....								
139.	Percentage of invested capital equal to percentage of inadmissible assets (except obligations of United States) to total admissible and inadmissible assets (Art. 852) (p. 721).....					xx	xxx	xxx	xx
140.	Total adjustments to be deducted (sum of items 124 to 139).....								
141.	Adjusted invested capital (item 123 minus item 140).....	C141				D141			

(1) But not including the invested capital of any affiliated corporation organized after August 1, 1914, and not successor to a then existing business 50 per cent or more of whose gross income was derived from Government contracts or sub-contracts made between April 6, 1917 and November 11, 1918. Such corporation shall be assessed separately. (Sec. 240.) If corporation has undergone reorganization, consolidation or change of ownership since January 1, 1911, or has been organized subsequent to December 31, 1917, see Sections 130 and 331.

\*Amounts to be added are the balances in these accounts at the beginning of the fiscal year.

\*\*This amount should be such percentage of the amount received or paid as the percentage which the number of days remaining in the fiscal year after date of payment bears to 365 days.

# FORM FOR CALCULATION OF AMOUNT OF CORPORATION INCOME, EXCESS AND WAR PROFITS TAXES

Taxable Year Ended.....1918

## EXCESS PROFITS TAX (1918)

(Compute tax for full fiscal year, whether it is same as calendar year or not.)

201. Excess profits credit = 8% of item C141 =	\$	plus \$3,000 =	\$	First Bracket
202. 20% of item C141 (or item A40 if less than 20% of item C141)	\$	less \$	= \$	Second Bracket
		(Item 201)	@30% =	
203. Remainder of net income	\$	less \$	= \$	
204. Total net income (item A40)	\$		@65% =	
War Profits Credit:				
205. Sum of first and second brackets =	\$			
206. Average annual pre-war earnings (1911, 1912, 1913) as in 1917 return	\$			
207. 10% of invested capital for fiscal year (10% of C141)	\$			
208. 10% of average invested capital (1) for pre-war period	\$			
209. Difference: 207 minus 208 (or 208 minus 207 in red)	\$			
210. Total (sum of items 206 and 209)	\$			
211. Bring down item 210 or item 207, whichever is greater	\$			
212. Specific exemption	\$			
213. Total war profits credit (sum of items 211 and 212)	\$			
214. Net income (item A40), less item 213 =	\$	× 80% =	\$	Third Bracket
			b less item 205 =	
<p>Note a: A different rule will apply if corporation was not in existence during the whole of at least one calendar year during pre-war period. See Act, Section 311 (c).</p> <p>Note b: If b is smaller than item 205, there is no tax under the third bracket.</p>				
Maximum Provision: (Excess profits tax shall in no case exceed item 218)				
215. Total excess profits tax 1918 (sum of items 205 and 214)	\$			
216. Net income (if more than \$30,000), less \$30,000 =	\$	× 80% =	\$	
217. Net income in excess of \$3,000 and not in excess of \$30,000 =	\$	× 30% =	\$	
218. Sum of items 216 and 217	\$			

## EXCESS PROFITS TAX (1917)

(Compute this tax only if fiscal year is not calendar year.)

219. Exemption = % of item D141 (same % as in 1917 return),	\$	plus \$3,000 =	\$
220. 15% of item D141, =	\$	less \$	= \$
		(Item 219)	@20% =
221. 5% of item D141, =	\$	less \$	= \$
			@25% =
222. 5% of item D141, =	\$	less \$	= \$
			@35% =
223. 8% of item D141, =	\$	less \$	= \$
			@45% =
224. Remainder of net income	\$	less \$	= \$
			@60% =
225. Total net income (item B40)	\$		c.
226. Total excess profits tax (1917) =	\$		

Note c. But if corporation is a holding or controlling company, use amount of net income as determined from consolidated statement.

\*If excess profits credit or exemption cannot be entirely deducted in the first bracket, the remainder may be deducted in the succeeding bracket or brackets.

## INCOME TAX

(If fiscal year is not calendar year, apportion total amounts to 1917 and 1918 below in the ratio of the number of days of fiscal year falling within 1917 and 1918 respectively.)

227. Net income, (item A36, apportioned if fiscal year is not calendar year)	\$	1917	1918
228. Net income, (item B36, apportioned)	\$	\$	\$
229. Excess profits tax 1918 (item 215 or 215 apportioned; but if item 215 is more than item 218, then item 218 or 218 apportioned)	\$	\$	\$
230. Excess profits tax 1917 (item 226 apportioned)	\$	\$	\$
231. Net income less excess profits tax	\$	\$	\$
232. Specific exemption of \$2,000 (apportioned if fiscal year is not calendar year)	\$	\$	\$
233. Subject to income tax	\$	\$	\$
234. 6% of amount for 1917 (item 233)	\$	\$	\$
235. 2% of any dividends (2) received apportioned to 1917, if fiscal year is not calendar year (p. 325)	\$	\$	\$
236. 12% of amount for 1918 (item 233)	\$	\$	\$
237. Total income tax (sum of items 234, 235, 236)	\$	\$	\$

Note d: If the 1918 excess profits tax should be disproportionately high as compared with that of representative corporations, a special ruling would apply under certain conditions (see Sec. 327, d).

## RECAPITULATION

238. Excess profits tax 1918 (item 229)	\$
239. Excess profits tax 1917 (item 237). No amount if fiscal year is calendar year	\$
240. Income Tax (item 237)	\$
241. Total	\$
242. Deduct: Any income, war profits or excess profits taxes paid to any foreign country upon income derived from sources therein, or to any possession of U. S., apportioned to 1918 (Sec. 238, c)	\$
243. Credit for any income or excess profits taxes already paid for this year under Act of Oct. 3, 1917	\$
244. Credit for tax on amount of loss in inventory values arising after end of taxable year, and rebate payments for which claim for abatement is made (p. 480)	\$
245. Net amount of tax due (item 241 minus sum of 242, 243 and 244)	\$

(1) Compute the invested capital as of the beginning of each of the years 1911, 1912, and 1913, and ascertain the average. For this purpose follow the 1918 basis of classification as defined by column C on page 2. The average invested capital for the pre-war period as determined for the 1917 excess profits tax will not apply for 1918 because of variations in the definitions of invested capital in the two laws.

(2) But the rate would be only 1% on any dividends received out of earnings of 1913, 1914 or 1915.

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